IDEAS FOR LEADERS | DECEMBER 2019

# banking insight

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**EXCLUSIVE INTERVIEW WITH DATUK YVONNE CHIA, CHAIRMAN OF STANDARD CHARTERED BANK (MALAYSIA) BERHAD**

**AT THE TOP OF HER GAME**

Scepticism: An Essential Quality For Banking Professionals

**CULTURE IN GOVERNANCE MATTERS**

# Up in Arms

Are you financing weapons of war?

TAX THAT BOT!

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Editor's Note

# UNCEASING EFFORTS TO WREST WHITE-COLLAR CRIME

**AS 2019 DRAWS TO A CLOSE,** we reflect on the momentous events that have marked our journey toward elevating professional and ethical standards in banking.

Of the many milestones, few have been more rewarding than the successful conclusion of AICB's International Conference on Financial Crime and Terrorism Financing (IFCTF) 2019 in November.

Convening global top financial crime experts and industry veterans in Kuala Lumpur, this year's theme – *Building Trust and Transparency: Collaborate, Accelerate, Strengthen* – is a clarion call for financial institutions to dig their heels deeper and combat criminal behaviour in the financial system.

World renowned experts at the IFCTF 2019 include Tom Keatinge, Director, Centre for Financial Crime and Security Studies, Royal United Services Institute; and blockchain expert Roberto Capodieci of Blockchain Zoo, Indonesia.

Tun Dr Mahathir, the Prime Minister of Malaysia, launched the much-awaited Malaysia Financial Intelligence Network (MyFINet), an intelligence-sharing partnership to counter money laundering and terrorism financing, comprising the Royal Malaysia Police, the Malaysian Anti-Corruption Commission, the Royal Malaysian Customs, Securities Commission Malaysia, and 18 other reporting institutions.

In his keynote address to over 1,300 delegates, Tun Dr Mahathir said: "While we appreciate the insights and the latest development in dealing with the present day sophistication of financial crime and terrorism financing, the chink to the armour is always linked to bad and ineffective governance due to lack of integrity."

"I used to say that previously, when corruption was an 'under the table' act, it was a scourge to our nation's future. But the last few years saw corruption becoming an 'over the table' act, being committed openly by the top leaders. Others will then do the same without fear."

How timely then that *Banking Insight* takes the bull by its horns with a hard-hitting exclusive on the perils of proliferation deals, *Up in Arms: Are You Financing Weapons of War?* It questions whether banks' zero-tolerance for corruption is out of sync with reality in the arms trade.

Weighing in is Datuk Yvonne Chia, AICB Council Member and Fellow Chartered Banker, whose trailblazing career follows a life of purpose and mission. Insightful, motivational, and personal, she shares her philosophy as well as predictions on banking's not-too-distant future.

As always, keeping our members on point, *Banking Insight* presents forward-looking trends from global thought leaders.

Alex West, also on the panel at the IFCTF 2019, elaborates how banking technology has caught up with aspiration as surveillance efficiency evolves, linking isolated occurrences into patterns of behaviour to deliver more granular detection of market abuse.

Brian Hansen advocates why diversity in cybersecurity enhances operational effectiveness through the cultivation of different perspectives and talents for creative problem-solving. As cybercriminals are single-mindedly collaborating to cheat the system, leaders must incorporate diversity as "a business imperative, not a nice-to-have".

Which begs the question: Can we win the race against white-collar crime?

The jury is still out.

It is certainly food for thought as financiers take a well-deserved breather from boardrooms, banking halls, and trading floors. ✱

*Hope you have a fruitful read.*

**The Editor**

**+ Convening global top financial crime experts and industry veterans in Kuala Lumpur, this year's theme – *Building Trust and Transparency: Collaborate, Accelerate, Strengthen* – is a clarion call for financial institutions to dig their heels deeper and combat criminal behaviour in the financial system.**

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# bankinginsight

Ideas for Leaders




**Editor** | Prasad Padmanaban **Assistant Editor** | Shireen Kandiah
**Writers** | Angela Yap Siew Peng, Julia Chong, Kannan Agarwal, Dr Amanda Salter, Adelene Teo

PUBLISHER

**Asian Institute of Chartered Bankers** (35880-P)
*(formerly known as Institut Bank-Bank Malaysia)*
Wisma IBI, 5 Jalan Semantan, Damansara Heights, 50490 Kuala Lumpur Malaysia
Tel: +603 2095 6833 Fax: +603 2095 2322 Email: enquiries@aicb.org.my

PUBLISHING CONSULTANT

**Executive Mode Sdn Bhd** (317453-P)
Tel: +603 7118 3200 Fax: +603 7118 3220 Email: executivemode@executivemode.com.my

PRINTER

**Percetakan Lai Sdn Bhd**
No.1, Persiaran 2/118C, Kawasan Perindustrian Desa Tun Razak, Cheras, 56000 Kuala Lumpur
Tel: +603 9173 1111 Fax: +603 9173 1969


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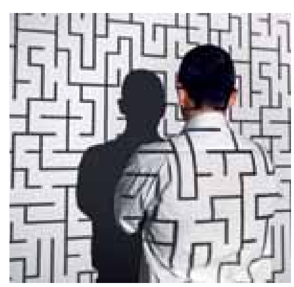

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Vibrant, bold, and incisive as ever, Datuk Yvonne Chia, FCB, Chairman of Standard Chartered Bank (Malaysia) Berhad, graciously pulls back the curtain on her defining moments and shares her thoughts on banking's future.

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# BUSTING FINANCIAL CRIME & TERRORISM

*From left: Arsalaan Ahmed, Secretary, Association of Islamic Banking Institutions Malaysia; Tan Sri Tay Ah Lek, MD/CEO, Public Bank Berhad; Tan Sri Azman Hashim, Chairman, AICB; Datuk Syed Zaid Albar, Chairman, Securities Commission Malaysia; Datuk Nor Shamsiah Mohd Yunus, Governor, BNM; Tun Dr Mahathir Mohamad, Prime Minister of Malaysia; Latheefa Koya, Chief Commissioner, MACC; Dato' Pahlawan Mazlan Mansor, Deputy Inspector-General, Royal Malaysia Police; Dato' Azimah Abd Hamid, Deputy Director General, Royal Malaysian Customs (Enforcement/Compliance); Nik Azmir Nik Anis, Organising Chairman & Chairman, AICB Compliance Officers' Networking Group; Prasad Padmanaban, Chief Executive, AICB.*

Jointly organised by the Asian Institute of Chartered Bankers and the Compliance Officers' Networking Group, the 11th International Conference on Financial Crime and Terrorism Financing gathered over 1,300 leading regulators, experts, thought leaders and industry practitioners onto a common platform to debate and consolidate global efforts to combat financial crime. Supported by Bank Negara Malaysia, Securities Commission Malaysia and Labuan Financial Services Authority, this year's theme – *Building Trust and Transparency: Collaborate, Accelerate, Strengthen* – covered a range of issues from the systemic challenges of bribery and corruption to increasingly complex threats such as money laundering, proliferation financing, and cybersecurity.

The conference convened luminaries such as Tun Dr Mahathir Mohamad, the Prime Minister of Malaysia; Datuk Nor Shamsiah Mohd Yunus, the Governor of Bank Negara Malaysia; Latheefa Koya, the Chief Commissioner of the Malaysian Anti-Corruption Commission and Tan Sri Azman Hashim, the Chairman of AICB. They shared their riveting bird's-eye views alongside global subject matter experts. ✱

**"I wish to applaud the Financial Services Professional Board (FSPB) on its recent publication of standards on whistleblowing and on managing conflicts of interest…I hope that the industry will adopt these standards and this means moving beyond symbolic gestures, to the diligent implementation of policies and programmes that promote the desired culture."**

**Datuk Nor Shamsiah Mohd Yunus**
*Governor of Bank Negara Malaysia*

**"AICB focusses its efforts on raising the professional and ethical standards of bankers through our membership and professional qualifications as we believe that capacity building plays an important role in preparing bankers for the fight against financial crime and maintaining the highest levels of integrity in one's professional practice. It is vital for bankers to have a code of ethics that promotes honesty, accountability and ethical conduct to maintain the highest levels of integrity in their professional practice."**

**Tan Sri Azman Hashim**
*Chairman of AICB*

## EUROPE'S EUR60 BILLION 'ROBBERY OF THE CENTURY'

That's how French newspaper *Le Monde* describes the Cum-Ex scheme, a massive EU trading scandal involving an extensive network of bankers, traders ,and lawyers. Uncovered in 2012 by a collective of European investigative journalists on tip-offs from German whistle-blowers, the plot to siphon taxpayers' money from state funds is estimated to reach up to EUR31.8 billion in Germany, EUR17 billion in France, EUR4.5 billion in Italy, EUR1.7 billion in Denmark, and EUR201 million in Belgium.

Trials commenced in Bonn on 26 March 2019 to convict the alleged perpetrators on multiple counts of economic espionage, violation of banking secrecy laws, and tax fraud.

One of the architects of the scheme, Oxford-trained investment banker Martin Shields, testified that the scheme reflects the attitude of banks and bankers who were bent on "taking advantage of any opportunities that could be found or created. This was not the clandestine approach of a few. Rather, I saw it as the clear and openly communicated expectation of most major banks and their customers."

Has banking truly laid the ghost of 2007 to rest…or are there more criminal spectres lurking in the shadows? ✱

# AT THE Top of Her Game

VIBRANT, BOLD, AND INCISIVE AS EVER, **DATUK YVONNE CHIA, FCB, CHAIRMAN OF STANDARD CHARTERED BANK (MALAYSIA) BERHAD,** GRACIOUSLY PULLS BACK THE CURTAIN ON HER DEFINING MOMENTS AND SHARES HER THOUGHTS ON BANKING'S FUTURE.

**Q Your career has been marked by many Malaysian 'firsts', including the first female CEO of a commercial bank and steering two banks simultaneously during the Asian financial crisis. Please share your journey in charting your course in the sector.**

In my early days, I didn't know I wanted to be a banker but I knew I wanted to work for a multinational. Then I got lucky; I got my start in banking with a global bank. I fell in love with it and it became the catalyst for me to explore my full potential.

The excitement and fast-paced nature of finance, and the landscape pushes you to constantly evolve. I was hungry to learn, to stay ahead and, most importantly, excel in what I loved to do.

Anything you set out to do in life can only be sustained if your actions resonate with your inner voice. It'll drive you to wake up early, feel excited about your job, leave money out of the equation, and in the process, feel contented and fulfilled. Before you know it, you are on the road to further success.

In retrospect, I believe my character and values were indelibly shaped by my 50-year-old father who suddenly passed away when I was a young teenager.

I was raised in a Hokkien household in Seri Menanti/ Kuala Pilah, where my father owned and operated the family business – a wholesale store,a retail grocery shop, a one-pump petrol station, a rubber factory, and a four-lorry fleet for hire – while my mother was a traditional housewife. Many knew me as the tauke's (boss') daughter as I followed him in his lorry along the supply route to the smaller towns before heading to school in the afternoon.

This was my first peek into entrepreneurship. As I watched my father, I picked up practical business knowledge on negotiating deals and collections, decisions to extend or withhold

Looking back, I am grateful to have contributed in a small way in shaping the Malaysian banking landscape, especially through leading three big bank mergers, including the Kwong Yik–RHB merger, the RHB–Sime Bank merger, the Hong Leong Bank–EON Bank merger and several smaller finance company mergers, as well as the first Islamic Bank merger (EON Islamic–Hong Leong Islamic).

credit, and building friendship and camaraderie.

We were not prepared for his sudden death and with it, my family lost the business as my eldest brother was studying overseas and was not ready to take over. As a young teenager, this ironic twist of fate left a deep impression within me of how comfort and wealth can disappear so easily. I learnt that adversity can strike at any time; I was determined to be financially independent and to take control of my own destiny. I wanted to have my own pocket money and tutored after school. Then I got a scholarship to University of Malaya.

From then on, assessing the risk at hand has been crucial to every decision I've made, in banking as well as in life. That is very much the first chapter of my life's journey.

Where I am today is a combination of hard work, being at the right place at the right time, and having people who believe in me. I also always tell myself that as a woman leader, I must lead the industry well and leave a good example for future women bankers to emulate.

During the Asian Financial Crisis, I was simultaneously the CEO of two banks – a performing bank and a non-performing bank – for a period of 18 months, where I subsequently brought them together. This was one of the most exciting times for me, testing my leadership in crisis management where I had two separate lines of accountability, one to the Banks' Board and one to the Central Bank of Malaysia. I learnt a lot from that experience – managing under stress, seeing mistakes made, and motivating confidence and morale in difficult times. This was a defining moment in my leadership journey.

Due to this crisis, the Central Bank came out with the First and Second Financial Masterplans to further develop and strengthen the banking and financial sector in Malaysia. I believe that going through this phase of pain as a country made us stronger. Today, I think we have one of the most forward-looking sectors in the country, coupled with strong banking and training institutes, including the Financial Institutions Directors' Education programme, the Asian Institute of Chartered Bankers (AICB), and the Asian Banking School, to continuously strengthen competencies whilst embedding the importance of building a culture of professionalism. I am glad I was in the midst of this development and now have so much to share on my journey as a banker, the conduct of banks and societal impact, as well as the understanding of human characters during a crisis and their values.

Looking back, I am grateful to have contributed in a small way in shaping the Malaysian banking landscape, especially through leading three big bank mergers, including the Kwong Yik–RHB merger, the RHB–Sime Bank merger, the Hong Leong Bank–EON Bank merger and several smaller finance company mergers, as well as the first Islamic Bank merger (EON Islamic–Hong Leong Islamic).

Following the heady excitement of my last big bank merger in 2011 (EON–Hong Leong), everyday operations became mundane. Also, I was approaching 60 years old and it had then been 10 years on the job at Hong Leong and was time to move on.

Especially on the family front, I missed out on quite a bit. The woman and mother in me was pulling me back. I've always said that whilst men carry on with their careers well into their twilight years, Mother Nature will ultimately bring women back to our roots as nurturers.

In fact, two months after I left my full-time CEO role, I became a grandmother.

**Q As regulatory focus shifts from financial resilience to operational resilience – the ability of banks to withstand disruptions and deliver uninterrupted services – what practical advice can you share on navigating today's sea of vulnerabilities?**

Unfortunately, we have failed society with the disreputable conduct unveiled post-2008 global financial crisis (GFC), which is still fresh in people's minds. Banking has to evolve and do the right thing in order to leave a strong, sustainable impact on society and the economy at large. It is very disappointing that despite all the risk frameworks and scenario planning in place, bankers and banking institutions have settled for short-termism and are still reeling from it, putting the organisation at inappropriate risk.

**Drop short-termism and misaligned investments. Value creation is about consistent profitable growth and should include all stakeholders, especially the customer value proposition and not just follow the old way of focusing on primary stakeholders. I'd be surprised if the average banker didn't already think this way.**

A few pearls of wisdom that have also served me well:

**Always go back to the fundamentals.** Respecting the empirical facts, including the negatives, as well as scenario planning for understanding the capital at risk. Walking away from deals and mergers and acquisitions may sometimes be necessary.

**Drop short-termism and misaligned investments.** Value creation is about consistent profitable growth and should include all stakeholders, especially the customer value proposition and not just follow the old way of focusing on primary stakeholders. I'd be surprised if the average banker didn't already think this way. Hopefully we have all learned the lessons and moved forward to do the right thing with the wisdom and knowledge of seeing the disastrous outcomes when we shortchange. It is imperative that we protect the franchise and organisation over individual egos rather than being blind followers.

**Reputation matters.** This is about consistent action, authentic and adaptive leadership, and being guided by the values and purpose of banks. The conduct of bankers and banks are being watched and regulated so we must do the right thing for the stakeholders whom we serve.

Today banks are being watched on the direction to support sustainable practices and balance economic,environmental and social needs.Investors,employees and the public eyes are increasingly monitoring these actions by banks and the responsibility to support sustainable economic activities.

**Engage with people at different levels.** The key is being authentic to yourself as well as fair and forthright with others. It exemplifies the power of gratitude and humility, which are important values that every leader must

**We must have leaders with the right values. This is especially true in banking, where we are custodians of other people's money, to whom the depositors have entrusted us with fiduciary duties. Whether in the private sector, public sector, or civil service, there is a clear line in the sand when it comes to understanding the distinction between personal assets, custodian/trustee roles, and what belongs to the public at large.**

hold dear. Especially in managing relationships, it has to be a win-win for everyone.

Younger CEOs are also coming onboard now and we need to listen to their thinking and empower them. They have new challenges in cybersecurity, data management, cross-border flows, and blockchain in the digital world. Despite the advancement of technology, they must muster the fundamentals of banking, which do not change. We must remind ourselves that ethical conduct and professionalism over time will decide our respective personal reputation and the organisations we lead.

**Q A hallmark of the Chartered Banker – the gold standard in banking qualification – is that he/she instils trust. Post-GFC, as a new generation of consumers increasingly trust tech, what must bankers do to bring the ball back to their court?**

Today, we continue to get bank-bashing post-2008 global financial crisis.

The tone at the top sets the ethical climate of the day. We must have leaders with the right values. This is especially true in banking, where we are custodians of other people's money, to whom the depositors have entrusted us with fiduciary duties. Whether in the private sector, public sector, or civil service, there is a clear line in the sand when it comes to understanding the distinction between personal assets, custodian/trustee roles, and what belongs to the public at large. This is where consequential decision-making and accountability must prevail.

Our financial institutions must be transparent, continuously engage with stakeholders, and be clearly guided by the values of integrity, professionalism and ethics. With the establishment of the AICB, it is good to know that individual members are also encouraged to grow their competencies, capabilities, and knowledge via professional qualifications and thought leadership. The Institute's Code of Professional Conduct guides bankers to further enhance the reputation of the banking industry and strengthen public trust.

**Q In the race to acquire top talent, banks are increasingly investing in its people. You've also emphasised that individuals, especially women, must invest in themselves. What are the skills or values that organisations and individuals must possess in order to achieve peak potential?**

Our financial institutions must be transparent, continuously engage with stakeholders, and be clearly guided by the values of integrity, professionalism and ethics. With the establishment of the AICB, it is good to know that individual members are also encouraged to grow their competencies, capabilities, and knowledge via professional qualifications and thought leadership.

Building personal capacity via knowledge enhancement is important and is a continuing journey. Prepare yourself for the future. Immerse yourself in the industry. Stay ahead of developments and interact with people and customers from different backgrounds and specialisms.

Your degree or qualification is only the first step. More than 90% of what I learnt was on the job.

Real life experience is priceless. It is how you apply your critical thinking, coupled with the impetus to learn, relearn, and adapt to an ever-changing ecosystem, which will determine your relevance.

As you move up the ladder as a leader, effective people management and surrounding yourself with the right competencies become increasingly compelling. It is the job of a leader to harness a team of people to perform well and successfully deliver the organisation's objectives, as well as drive appropriate behaviour and conduct accordingly.

Ask yourself: How do I add value to the organisation? In what capacity can I shine? Build knowledge, widen your range of skills and network. Then have a plan for your career and be open to exploring opportunities beyond your current position. Most importantly, if you do what you love, you will excel.

**Q If you were to come back for an interview with us in 10 years, what do you imagine banking would look like?**

I believe I'd wake up to find banking fully embedded in artificial intelligence (AI) and machine learning as a primary delivery platform.

Digital currency, digital identity, blockchain, and encryption will be the new standards for financial services.

In this new world, we will see behavioural patterns incorporated in the decision-making algorithm. Where will the accountability be between mistakes in AI and outcomes? There is the 'dark' side of data that can be disastrous to the individual and society so we will be thinking about AI strategy aligned for the good of society.

In this way, the 2019 United Nations' Principles of Responsible Banking is a great start to acknowledge these potential problems in an AI environment. AICB's push into raising the professionalism and ethics as a set of principles for accountability of individual conduct is an imperative. How we adapt and push this professional conduct as digital ethics is something we will also be exploring.

I see banks will come into its true role of serving economic growth and driving change, funding the sectors that are truly making the future sustainable for all of us and the generations to come. ✱

BY ANGELA YAP SIEW PENG

# UP IN ARMS

## ARE YOU FINANCING WEAPONS OF WAR?

When asked to describe banks' ability to detect illicit financial transactions, one risk manager at a major bank said: "We only catch the dumb ones."

The interviews, conducted by financial crimes expert Dr Togzhan Kassenova and published in a research paper titled *Challenges with Implementing Proliferation Financing Controls: How Export Controls Can Help for Carnegie Endowment for International Peace,* illustrates the challenges banks have in wrapping their heads around the illicit financing of weapons of mass destruction (WMD), also known as proliferation financing.

"Compared to money laundering and terrorism financing, proliferation financing is a relatively recent and less understood challenge," writes Dr Kassenova.

### A CHANGING TYPOLOGY

There is no universally accepted definition of proliferation financing.

The Financial Action Task Force (FATF) defines proliferation as the transfer and export of nuclear, chemical or biological weapons; their means of delivery; and related materials that may or may not be included in control lists as 'sensitive materials'.

Proliferation financing is the trade financing and other forms of financial support extended to persons and entities engaged in the procurement of illicit arms.

Yet, as Dr Kassenova points out, this is increasingly difficult to pin, given that almost anything could potentially be used to construct a WMD.

"The risks posed by WMD stem not only from ready-made bombs, nuclear, chemical, or radiological material, but from dual-use goods and technology that are traded, shipped, and used globally.

"Laptops, transistors, instant coffee – almost every single moment, no matter where you find yourself in the world, you are surrounded by

The risks posed by WMD stem not only from ready-made bombs, nuclear, chemical, or radiological material, but from dual-use goods and technology that are traded, shipped, and used globally.

**Dr Togzhan Kassenova**

products that rely on the same technology and material as weapons of mass destruction.

"Semi-conductor material that is indispensable for laptops and transistors can be used in military equipment. Production of instant coffee, as well as of dry ice-cream for astronauts, relies on freeze-drying technology that can be used in bio-warfare research. Components for nuclear power reactors that generate electricity rely on dual-use components and technology that can be used in a nuclear weapons programme."

In a sign of the times, the US Supreme Court set a precedent at the 2006 trial of terrorist Zacarias Moussaoui, an al-Qaeda member and would-be hijacker in the 9/11 attack, when the former defined 'airplanes used as missiles' as a WMD.

This changing typology of proliferation financing does not bode well for banks accustomed to clearly defined rules and boundaries under the Basel regime.

## GREY LIST/GREY AREA

As terrorism continues to cast its long shadow, FIs should stay abreast of international obligations established by the FATF and UN Security Council (UNSC), the global standard-setters in this regard:

+ **UN Security Council Resolution 1540 (UNSCR 1540).** This resolution was adopted in 2004 and is the basis for all subsequent UNSC resolutions related to WMD. Member states should pass national legislation and take measures to prohibit and penalise banks which finance the manufacture, acquisition, possession, development, transport, transfer or use nuclear, chemical or biological weapons, and their means of delivery, for terrorist purposes. The sanctions imposed by the UNSC include implementation of targeted financial sanctions against actors engaged in or providing support for proliferation-sensitive activities and programmes of North Korea and Iran.
+ **FATF Recommendation 7 and Interpretive Note.** Issued in 2008, the guidance requires countries to implement targeted financial sanctions to comply with UNSCRs relating to the prevention, suppression and disruption of proliferation of WMD and its financing. The accompanying Interpretive Note sets out specific requirements concerning targeted financial sanctions, including designations, assets freezing/unfreezing, delisting, and providing access to frozen funds.

None of the above are binding on member states, although countries that do not meet these standards risk being blacklisted.

In June 2018, the FATF placed Pakistan on its 'grey list' as it failed to complete its action plan on terror financing. Twelve months later, the Paris-based body issued a stern warning when it assessed "that not only did Pakistan fail to complete its action plan items with January deadlines, it also failed to complete its action plan items due May 2019".

At the time of this article, the FATF warned Islamabad it must meet the final October 2019 deadline or be blacklisted as a 'non-cooperative nation'. This will trigger similar downgrades by multilateral lenders such as the IMF, EU, and reduce its risk rating by Moodys and Fitch.

Regionally, a host of regional FATF-style bodies such as the Asia/Pacific Group on Money Laundering are tasked with ensuring its members implement international standards against proliferation financing.

Yet, a chasm remains between policy and reality.

The UK's Royal United Services Institute for Defence and Security Studies (RUSI) reports in *Countering Proliferation Finance: An Introductory Guide for Financial Institutions,* that "government initiatives on countering proliferation finance vary widely between jurisdictions, and mixed messages on effective strategies have been passed down from governments and regulators to the financial sector.

"As a result, many financial institutions (FIs), while they may have certain basic controls in place to counter proliferation finance, on the whole do not understand the contemporary realities of the threat they are facing and are failing to implement adequate internal approaches to counter proliferation finance."

**OBLIGATION TO DISRUPT**

What then should banks do?

Proliferation financing strikes at the heart of a country and banks have an obligation to disrupt the flow of money.

Aside from the obvious reputational risk of being labelled a financier of crimes against humanity, such banks are in the way of global security and prosperity. Stockholm International Peace Research Institute estimated that diverting just 10% of world military spending to social and development goals would be enough to end global hunger and poverty by 2030.

Nobel Peace Prize winner, the International Campaign to Abolish Nuclear Weapons (ICAN) reports that 325 FIs invested US$748 billion to the top 18 companies involved in nuclear weapons in the two years leading up to January 2019.

The influential coalition has identified hundreds of banks, pension funds, insurance companies, and asset managers with

**Regionally, a host of regional FATF-style bodies such as the Asia/Pacific Group on Money Laundering are tasked with ensuring its members implement international standards against proliferation financing.**

# A Farewell to Arms

On 8 July 2013, Singapore-based Chinpo Shipping Company Pte Ltd transferred US$72,017 from its Bank of China (BOC) account to a Panama shipping agent. The money was for the transit expenses for a North Korean container ship to pass through the Panama Canal from Cuba.

The vessel was operated by Ocean Maritime Management, a shipping company controlled by the Korean Ministry of Land and Marine Transport. On 13 July 2013, Panamanian authorities interdicted the vessel under the suspicion of carrying drugs.

Instead, hidden under 10,000 tonnes of sugar, authorities discovered two disassembled jet fighters, anti-tank rockets, surface-to-air missile systems, and their components.

A Singapore district court found Chinpo and its director, Tan Cheng Hoe, guilty of two felonies: transferring funds that could have been used to support North Korea's nuclear programme, and running a remittance business without a valid licence with over US$40 million transfers related to North Korean vessels.

Upon its appeal, the High Court cleared Chinpo of the first charge but upheld the second.

Chinpo hid its involvement with North Korea by removing the names of vessels and identifying details from forms and correspondences, allegedly at a BOC teller's recommendation.

Further investigations revealed North Korean entities shared an account at BOC in Chinpo's name and its diplomat would withdraw up to US$500,000 in bank notes to carry out of the country annually. The North Korean Embassy in Singapore also shared Chinpo's business address, employees and email account for communications.

Adapted from Chinpo Shipping: A Singaporean Financial Agent Of North Korea and RUSI report.

"There is a growing shift in the analysis of risk and return. Risk analysis that is solely focused on delivering the highest possible financial returns is no longer enough. Investment is changing. Investors are increasingly seeking opportunities to grow their wealth while contributing to the global good."

substantial investments in nuclear arms producers.

Its June 2019 report, *Shorting Our Security: Financing the Companies that Make Nuclear Weapons,* of the FIs investing in nuclear weapons, 90 are new (i.e. not previous investors) with investments totalling US$108 billion. In comparison, 94 institutions withdrew US$56 billion and ended any significant financial relationship with nuclear weapon producers.

"Almost one-third of all financial institutions listed in the previous year's report have fully divested, demonstrating that there are options in the market to allow any investor to both do well and do good," writes the principal author, Susi Snyder.

"There is a growing shift in the analysis of risk and return. Risk analysis that is solely focused on delivering the highest possible financial returns is no longer enough. Investment is changing. Investors are increasingly seeking opportunities to grow their wealth while contributing to the global good."

## DUCKING THE RADAR

Detecting the specific signatures of proliferation finance is more complex than decrypting and crippling terrorism financing.

Illegal arms dealers regularly duck international laws and financial regulations, often procuring goods just below the control threshold. The

UN reported in 2014 that only 10% of the goods it was investigating fell within the thresholds determined by control lists.

The RUSI report recommends these building blocks for an effective response to counter proliferation financing:

- **Conduct an internal risk assessment** to determine risk to proliferation risk, what level of risk the bank is willing to accept, measures to mitigate exposure, and whether any relationships fall outside of this spectrum.

- **Identify suspicious transactions** based on the FATF 'red flags' list. A red flag doesn't automatically make a transaction suspicious but will indicate if an investigation is warranted.

- **Focus on particular proliferators and areas of operation** by considering its risk situation in relation to a particular proliferator (e.g. Banks in China warrant particular consideration given the volume of direct and indirect North Korean business that flows through that country); and the extent of operations in jurisdictions where proliferators are known to operate, including correspondent banks and provision of shipping insurance.

- **Build a list-based screening approach and Know Your Customer (KYC).** Most FIs use third-party software to screen all incoming and outgoing

But illicit procurement often involves individuals and entities outside of sanctions lists with many actors blending illegal trade with legitimate commercial business in a web of middlemen, agents, multiple transhipment points, and false end-users to obscure the logistical path.

transactions against lists of entities and persons designated under international sanctions regimes.

But illicit procurement often involves individuals and entities outside of sanctions lists with many actors blending illegal trade with legitimate commercial business in a web of middlemen, agents, multiple transhipment points, and false end-users to obscure the logistical path.

The FATF recommends stakeholders develop a well-coordinated information-sharing mechanism to detect sanctions evasion.

Banks should also continuously upgrade KYC processes to determine the client's trade relationships with proliferators, proliferating jurisdictions, and due diligence process with its trading partners.

- **Identify proliferation-sensitive goods and technology** by screening documentation such as letters of credit received in support of financial transactions. Dual-use goods or goods which are sensitive/controlled are listed in international export control regimes such as The Wassenaar Arrangement.

Even if goods and technologies do not appear on one of the international export control lists, these are still subject to export control restrictions if the end use is for illicit purposes.

FIs can employ the method of exclusion, i.e. exclude clients or jurisdictions that are less at risk to trading in sensitive goods and technologies or jurisdictions, then focus on the ones that remain.

## CORRUPTION: A SCAR ON THE CONSCIENCE OF THE WORLD

One source at a global Europe-based defence firm, who spoke to this writer on condition of anonymity, said: "I've often been asked how I put up with the corruption in this business. People ask, 'Don't you get tired of it?'"

"It's not the fault of the bosses sometimes – I don't think they know what's going on. It's the people around them, the middlemen who say they can get you a meeting with the minister for a fee or close the deal for a cut with you in it."

Isn't it a bit naïve to think the bosses don't know?

"Maybe they do, maybe they don't. But that's the way it is," the source said.

Indeed, it harkens to these words by British journalist, Anthony Sampson, who eludes to the hand-in-glove relationship between the arms trade and corruption:

"It is not realistic to expect… countries to remove the corruption in buying weapons, unless there is equal effort from the industrialised countries to clean up the selling."

'Cleaning up the selling' means nothing short of scrubbing the system down to its bare bones; ridding it of launderers, terrorists, dealers…and financiers who – wittingly or unwittingly – grease the wheels of illicit arms deals.

Bankers cannot separate personal responsibility from corporate accountability.

It begins with the question: Am I financing weapons of war? ✱

■ *Angela Yap Siew Peng is a multi-award-winning entrepreneur, author, and writer. She is the Director of Akasaa, a boutique publishing firm with presence in Malaysia, Singapore, and the UK.*

# 'I HAVE NO VESTED INTEREST'

Ex-trader Kweku Adoboli takes on notions of **ethics, systemic failure, and banking's 'power few'** in this no-holds-barred interview.

Convicted in November 2012 for the US$2.3 billion trading loss at Swiss investment bank UBS, Kweku Adoboli served half of a seven-year prison term before being deported from the UK.

Now, the former equities trader is working to change the system.

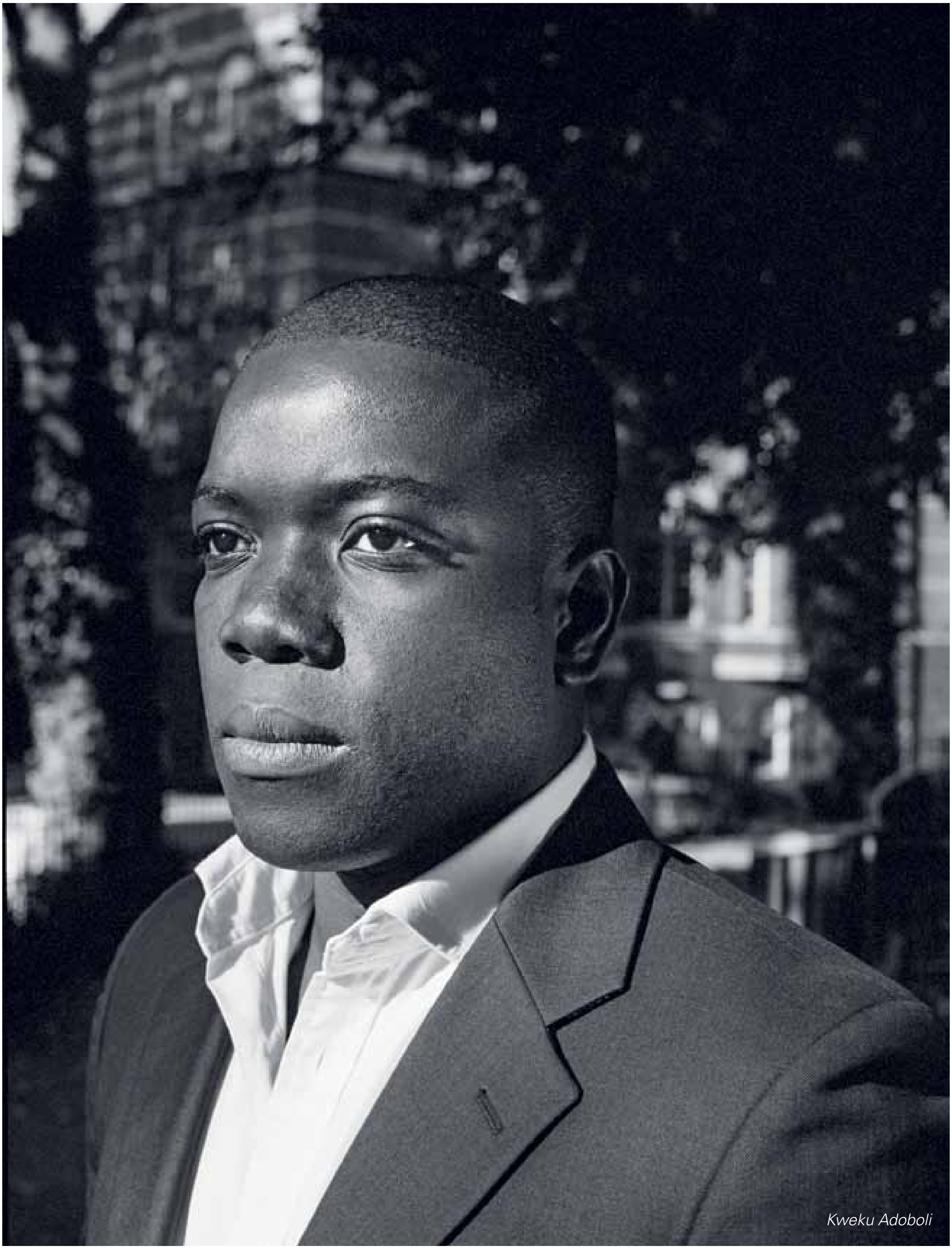
Since June 2015, Adoboli has worked with regulators, corporations, academics, and students on transformative risk management, ethics, and systemic failure.

Starting out as an operations analyst at UBS, within three years, he was recruited to the exchange-traded fund (ETF) and index desk on the equities trading floor. In 2007, with just 10 months under his belt as an ETF trader, he jointly managed the desk's US$50 billion trading book.

In 2011, under pressure to accelerate trading profits through client and proprietary trading, the desk incurred a significant trading loss. Kweku took sole responsibility for this and the systems employed by the desk.

In the final weeks before he was redetained and deported from the UK in November 2018, he worked with the counterterrorism unit of the UK Special Forces alongside ex-British Prime Minister Tony Blair, and British Army chief-turned-banking consultant General Sir Peter Wall.

Today, his view on ethics turns the table on conventional wisdom. He advises governments and the private sector on embedding ethics in organisational culture and the requisite system designs to keep the 'ethical engine' running.


Kweku Adoboli

**Q It's been more than 10 years since the global financial crisis, which some have referred to as a "systemic breakdown in accountability and ethics". Despite new regulatory reforms and ethical laws in place, high-profile financial scandals continue to take place. In your view, what do you think are the causes and how can institutions prevent this breakdown in accountability and ethics to create a more professional and accountable financial ecosystem?**

It would help if institutions would change their response to failure. In my experience, and as is becoming increasingly obvious to our global society, when failure happens today, organisations send in the very best lawyers to create a bunker and stop all information about the failure becoming public knowledge. This is done in an effort to protect institutional reputation and limit the fallout, especially to shareholders. To ensure the strategy is effective, we isolate individuals or small groups of people to assume the responsibility. This allows the status quo to persist.

In agreement with the argument advanced by Matthew Syed in his book *Black Box Thinking,* I believe it is vital that we reduce the blame culture that plagues our societies, drives a profound intolerance for failure, and stops us from taking deep lessons that would lead to better systems and help our institutions adapt to the needs of our societies.

The premise of this question is that more accountability results in better behaviour. But, if the accountability continues to be systematically placed merely at the individual level, it fails to address the drivers, i.e. excess complexity; target-oriented, yield-seeking behaviour; demoralising work; excess competition; conflict, etc. Perhaps counterintuitively, by resisting the temptation to find an individual or small group accountable, organisations would be more inclined to accept the true drivers of failure and put systems change into place at the institutional level to change behaviour.

So, the first step is to recognise drivers of failure. The second step is to be more honest about the fact the extractive purpose of the finance industry is grossly misaligned with the needs of our society and the social contract. The third is to reduce our blame culture. Then we can start to think about specific steps required to educate and enlighten people within the industry.

What is required goes well beyond accountability and increased regulation. For example, we must start tackling issues like the idea that some individuals are more talented than others because of their innate gifts, exemplified by the way we elevate some traders and bankers to star status, while keeping back office compliance, control and regulatory staff

**It would help if institutions would change their response to failure. In my experience, and as is becoming increasingly obvious to our global society, when failure happens today, organisations send in the very best lawyers to create a bunker and stop all information about the failure becoming public knowledge.**

at a hierarchically lower status than those traders. But Maryam Kouchaki at Northwestern University's Kellogg School of Management explains how important it is that we view organisations as flat and democratic hierarchies where everyone is capable of equal levels of creativity to solve problems.

"…we have to think about what else comes along with creativity. For example, it can create a sense of entitlement; a feeling that 'I deserve more than others'. In some ways, other people's behaviour reinforces this feeling in creative people. We treat them as special, and we hold them to a different set of standards. They begin to feel unique or rare. Then, when people think they are special, they start to think they can break rules and not be punished. There is a link between feeling entitled and being dishonest."

**Q Many professional bodies, banks, and financial institutions are now incorporating ethics training in their qualifications' curriculum and trainings. What do you think is the most important focus area for such trainings, and do you think they are effective in deterring financial misconduct?**

Ethics and conduct training courses focus on conduct at the individual level. However, the real issue is that most employees don't actually know when they are faced with an ethical dilemma. For example, my first trading role was as a 'Give Ups' trader in hedge fund services where my job was to facilitate a trading process designed to help our clients avoid paying stamp duty on equity trades, and to achieve yield enhancement by avoiding or reducing the taxes payed on dividends, etc.

It is only now – in cases such as Germany's investigation into BlackRock's involvement in the cum-ex scandal – we are looking back to realise it was unethical and unlawful to have wholesale practices and processes designed to deprive our society of the ability to collect taxes and returns from the finance industry. At the time, many who were involved in developing those practices believed that they were in pursuit of an ethical outcome because it was meeting the goals of their institution and industry as a whole. Yield enhancement, dividend and tax arbitrage are all mechanisms that are the opposite of acting in pursuit of the social contract. And yet, in my daily working life, I and everyone else around me came to internalise the idea that successfully achieving these outcomes was ethically sound. It should be no surprise that later in my career on the ETF and index desk, the pursuit of profit at any cost was an acceptable goal for us all.

To teach people to recognise an ethical dilemma when faced with one, we must first teach them how humans react when they face an ethical dilemma. This would seem obvious but we simply do not do this in the finance industry. Bazerman and Tenbrunsel in their book, *Blind Spots: Why We Fail To Do What's Right and What To Do About It,* explain how when you convert money into a token that represents the same value as money, decision makers are more likely to behave unethically. As we move inexorably towards cashless societies, we are effectively increasing the tokenisation of money, and as the evidence shows, we are more likely to behave unethically. We should be incentivising finance professionals to understand and avoid the potentially damaging ethical effects of the tokenisation of money.

I also believe we must do much more to encourage financial institutions to be honest about past failures, and incorporate historical lessons about these failures into ethics classes. We have yet to see evidence that conduct and ethics education has resulted in better behaviour within the finance industry. I suspect this is in part because the industry refuses to be honest about its past failures and the fact they were consistently driven by a desire to extract value and concentrate it in the hands of a powerful few at the top of our society.

**Q You had mentioned "decision fatigue" as one of the reasons for what occurred at the trading desk at the time, fuelled by a 'profit first' company culture. What can professional bodies and financial institutions do to create a mindset shift in bankers at all levels, from one that is profit-oriented to one where ethical practices take precedence?**

The decision fatigue was the result of a colleague and I, who with only 30 months of trading experience between us, were required to run a US$50 billion trading book when the head of our desk had left the bank. The equivalent desk at other big banks had as many as 11 traders. Over a period of four years, we survived the financial crisis and became an engine of growth for the bank's equities business. By July 2011, we were working 20 hours a day and, at our busiest periods, we measured making a new decision every 40 seconds for hours at a time.

The bank chose not to replace the head of our desk when they realised that to replace him would have cost ten times what they were paying him before he left the bank. The bank recognised they could reduce the cost and/or maximise the profits of the book by keeping the wage bill down. In doing so, they created a situation where in the first instance we did not have the relevant level of skill and experience to run a complex book. Secondly, this dynamic rendered us unable to express our concerns about our inability to run such a complex book through the most violent financial dislocation in recent finance history. When the goal became too difficult, struggling under the target, we were unable to vocalise our own concerns about our inability to meet those goals.

If I could speak to my 27-year-old self today, I would advise him to tell management that what they were asking us to do was too difficult and that they must either give us more resource to achieve what was being demanded of us, or accept that it was impossible to achieve. It cannot be expected of employees to be able to recognise that dilemma when faced with it. It is for people in leadership to recognise that dilemma on behalf of employees at every level, and set a mindset that allows those risks to be properly managed. This means that leadership needs to grapple with the complexity, conflict, and excess competition that is causing their employees to feel that they are doing demoralising work.

**Q Extreme failures are more likely the result of small groups of individuals — the 'power few' of corporate compliance — acting unethically or illegally, who by virtue of their social and organisational networks account for an outsized amount of bad conduct, and therefore harm. How can large organisations retune their compliance programmes to prevent potential damage by the 'power few'?**

At the root of the question is this premise that there are individuals within organisations that are the 'power few'. It is intentionally created by placing some employees on a pedestal in order to increase their influence and ability to act in pursuit of organisational goals. The effect, as noted above in reference to Kouchaki's work, is that creating a hierarchy of talent reduces the influence of risk control, compliance

and operational staff. Indeed, success in finance institutional settings is driven by the idea that some individuals are innately more talented than others.

At the core of the finance industry is a fundamental structural conflict where risk-takers are expected to push against regulatory and control boundaries, whilst controllers are expected to hold them back by enforcing regulations and policing their actions. This creates a destructive tension at the core of the industry that results in the very mindset that we are trying to correct: that it is acceptable to find ways to get around regulations and rules because the group assigned to hold you to account will give you a slap on the wrist if you stray beyond acceptable boundaries.

Historically, leadership has incentivised the front office 'power few' to encourage them to seek ways to break rules and get around regulations in the pursuit of profit. We have many nice euphemisms for this such as 'tax enhancement', 'regulatory arbitrage', etc. This creates a mindset and hierarchical structure that diminishes respect for people in compliance and control roles and leads to the very conditions for regulatory capture that we claim can only be avoided by keeping risk-takers and risk controllers on separate sides of this fundamental (but artificial) conflict. To fix this, we have to resolve the issue of the fallacy of talent and elevate risk control and compliance to their proper position as the guardians of ethical direction and propriety within the organisation. In so doing, risk controllers and compliance functions are more likely to be seen as equal partners in the pursuit of organisational goals, and front office risk-takers will come to recognise that the compliance, risk and control functions are there to assist rather than restrain them in pursuit of the organisations goals. Indeed, we should start with abolishing the terms 'front office' and 'back office'.

**Q Given your personal experiences, how do you think you can further contribute to the financial industry?**

As someone who does not have a vested interest in the finance industry status quo, I can speak openly about the challenges the industry faces and act as a lightning rod between the desires of society for a financial industry that meets the needs of the social contract, and the structural challenges the finance industry faces in delivering on that demand from our society.

I am a product of colonisation and globalisation and was lucky to grow up a child of the United Nations system. The early lessons I learned about why conflict resolution in the Middle East fails have been reinforced by the unique combination of opportunities for deep learning in the finance industry, the UK criminal justice, political and immigration systems, and now Africa's efforts to build a continental society that for the first time will be an equal partner on the global stage.

The finance industry is central to all these developments in our society and as such I think I have a responsibility to help draw the threads of these narratives to create insight for policymakers on how we rebuild trust and transparency in the finance industry; a goal which cannot be achieved without building a more equitable global society.

I do believe the vast majority of the finance industry genuinely desires to develop an industry that is trusted and central to the evolution and advancement of our global society. Unfortunately, we continue to rely on outdated organisational structures and mindsets, using 20th century management techniques in a 21st century society that will only thrive if we are able to develop value systems driven by transparency and trust built on a foundation of ethical soundness. My experiences of the last seven years have placed me in a unique position to help everyone find a way forward to improve culture and systems, whilst helping to rebuild trust between the industry and our wider society. ✱

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*The AICB hosted its 11th International Conference on Financial Crime and Terrorism Financing from 5–6 November 2019 in Kuala Lumpur, which included an exclusive session with Adoboli on 'Lessons from a Global Financial Catastrophe'.*

*Moderated by Prasad Padmanaban, the Chief Executive at AICB, the session presented a unique perspective with valuable lessons for participants, highlighting how quickly internal controls and ethical concerns can be overlooked in a profit-first corporate culture.*

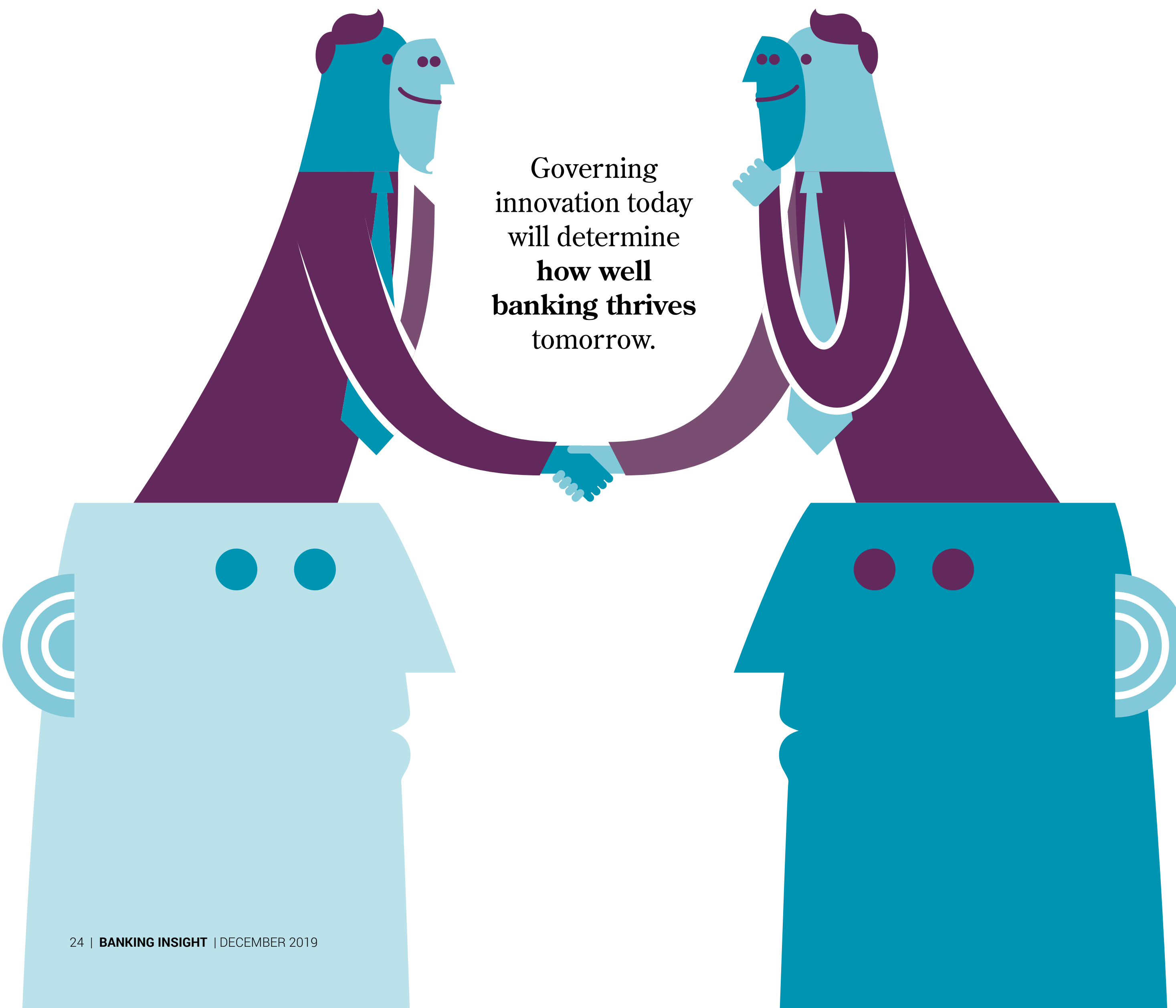
*As AICB continue to raise the standards of professionalism via its membership and professional qualifications, it is important that ethics training transition from theory to action and spur real change in banking.*

*The UBS scandal, a case study in many postgraduate courses, outlines how ambition, lax organisational standards and oversight can lead to consistent unethical behaviour.*

BY JULIA CHONG

# Licencing Fintech

## A.K.A. HOW TO GET ALONG WITH FRENEMIES



Governing innovation today will determine **how well banking thrives** tomorrow.

Frenemies – that's how Dave Curran, Chief Investment Officer for Australia's Westpac Banking Corporation, once described the relationship between banking and fintech.

"The concept of frenemies becomes a language that people are talking about," he said during a panel discussion in Sydney last year. "The banks know they need to work with fintech because that's how we provide better services to our customers. Similarly, fintech want to work with the banks because we have that base core logic and data that's important in terms of how we run financial services."

A portmanteau of the words 'friends' and 'enemies', but what Curran doesn't explain is the reason for this grudging relationship.

Banks spend billions of dollars annually to comply with stringent financial laws, resulting in rising costs and thinning margins for the section. Meanwhile, its fintech rivals exist as free enterprises with few laws and even fewer binding penalties in providing the same sort of service.

But not for long.

## EXTENDING THE REGULATORY PERIMETER

2019 has seen a host of new legislation and regime options to bring fintech into the regulatory fold. On one end of the spectrum, established financial hubs are holding the fort and insisting that existing laws regulate fintech like banks, whilst countries like Lithuania have jumped at the opportunity to licence fintech and become its next big hub.

### + Switzerland

At the turn of the New Year, the offshore financial centre's new regulatory licence category under the term *Innovationsförderung* (promotion of innovation) came into effect. It is informally dubbed the 'fintech licence' or 'banking licence light'.

Its governing agency, the Swiss Financial Market Supervisory Authority (FINMA), made partial revisions to the Banking Act and other legislation to create a new licence category with simplified requirements which permit fintech companies to:

- Accept public funds up to a maximum amount of CHF100 million (RM423 million), provided they neither invest nor pay interest on these funds and is subject to fulfilling conditions relating to its organisation, risk management, compliance, accounting, and retaining a minimum capital of CHF300,000 or 3% of deposits. The fintech must also have its registered office and conduct its business activities in Switzerland.
- Operate beyond the regulatory sandbox threshold previously established by FINMA, which did not require any licence but limited fintechs' ability to receive public funds beyond the CHF1 million threshold.

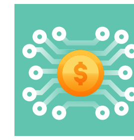
### + EU

The plurality (or divergence) of views within the economic bloc is vast.

For instance, Germany's regulator, the Federal Financial Supervisory Authority (BaFIN), outlined in its February 2019 digitalisation strategy that the principle of 'same business, same risk, same regulation' applies and fintech companies are subject to rules on par with banks.

In comparison, Lithuania has established itself as one of Europe's most exciting innovation hubs. The country has long been a gateway to the EU for Asian authorities, in particular China, and has recently seen a surge of interest from UK-based firms such as Google's Alphabet and popular digital wallet Revolut, which have applied for fintech licences to ensure it can provide uninterrupted services to all member nations post-Brexit.

As at March 2019, the Bank of Lithuania has already granted more than 110 licences to fintech companies ranging from crowdfunding and peer-to-peer lending platform operators



**+ 2019 has seen a host of new legislation and regime options to bring fintech into the regulatory fold. On one end of the spectrum, established financial hubs are holding the fort and insisting that existing laws regulate fintech like banks, whilst countries like Lithuania have jumped at the opportunity to licence fintech and become its next big hub.**

to electronic money and payment institutions.

In a bid to study the risks this holds for the EU, the European Securities and Markets Authority (ESMA) conducted a series of extensive surveys and deliberations with member nations and concluded in its July 2019 report, *Licensing of FinTech Business Models,* that most fintechs can operate within the current EU framework.

It espouses that two principles, namely proportionality and flexibility, should guide supervision in each member nation.

Proportionality ensures that rules are applied appropriately given an institution's size, organisation, scope, and complexity to achieve the desired objective. In Germany's case, BaFIN has decided that although the same laws apply for banks as well as fintech, the proportionality principle will determine the intensity of supervision.

Flexibility empowers member states to devise individual fintech licensing regimes as long as it corresponds to the EU legislative framework. This allows nations like Lithuania to leverage on the booming fintech sector as long as it stays within the parameters set out for all EU members.

ESMA concluded that there was no need for additional regulatory changes at this stage.

### + Asia Pacific

This is a whole different kettle of fish. Whilst many have not enforced a specific regulatory regime governing fintech, there are exceptions.

The Australian Prudential Regulation Authority (APRA) recently green-lighted the application for the country's newest bank, a fintech named 86 400 Ltd, to operate as a full-fledged bank under the Banking Act 1959. This required the fintech to meet the same stringent requirements as its Big Four banks – ANZ, Commonwealth Bank, NAB, Westpac – who control approximately 95% market share.

It is the third fintech startup to be granted a full licence as an authorised deposit-taking institution (ADI), meaning that it can take unlimited customer deposits.

The country also has a restricted ADI licence that allows fintech to offer banking products to staff and friends, family, and a number of early adopters, but not to the general public.

In comparison, Singapore and Hong Kong – two cities competing to be Asia's leading fintech hub – governed through existing legislation for the banking sector and only in recent times have moved to issue a limited number of digital banking licences in the vein of Canberra.

For instance, the Hong Kong Monetary Authority previously stated that "the premature and indiscriminate introduction of exhaustive regulations, based on a 'zero-risk tolerance' and 'no gaps allowed' mindset, may hinder the development of fintech."

Like Singapore, it chose to rely on existing banking laws and licences to govern innovation.

But that mindset is shifting, albeit, rather slowly.

Most recently, in July 2019, Tharman Shanmugaratnam, Chairman of the Monetary Authority of Singapore (MAS), announced the city-state would issue five virtual banking licenses to cater to SMEs and non-retail segments as part of MAS' pilot to consider more licences for fintech in future.

Subsequently, it issued the first fintech licence to Ping An Group, China's second largest peer-to-peer funding platform. Other digital pure plays such as Grab and remittance startup InstaReM have expressed interest in the licence as well.

## GORILLAS IN OUR MIDST

As if frenemies weren't enough, there's also the emergence of 'digital gorillas' otherwise known as Big Tech. The epithet refers to the sheer scale and reach of tech conglomerates like Apple, Google, Facebook, Amazon, Alibaba, whom many experts believe can disrupt banking far more than fintech.

A former senior executive at one of Australia's Big Four banks once described it thus: "The digital gorillas – Amazon and Google – perhaps haven't put their foot into the ring in a large way just yet, but we recognise that they can make that choice and they have very deep pockets."

Just how deep a wound can these 'deep pockets' create?

Apple Pay, Google Pay and Alipay are proprietary digital wallets or online payment platforms with million-dollar turnovers; Amazon is a behemoth that bundles everything

– from discount and free shipping to roadside assistance – to a traditional banking account; and Facebook's announcement of its proprietary cryptocurrency Libra has the potential to destabilise the international monetary system.

## TIES THAT BIND

The bigger question isn't if regulation will stifle innovation but whether the entire framework of awarding banking licences is out of sync with innovation itself.

Many argue that the current regulatory framework has changed little since it was set up during the days of the industrial revolution; it functions to maintain law and order in brick-and-mortar setups but is ill-equipped to govern the amorphous structure of fintech, where risks are constantly shifting like the dunes of the Sahara.

In a keynote at Cornell University on 28 February 2019, Professor John Iannis Mourmouras reasoned that the nature of risk is ever-changing and one should always expect new or evolving risks for the system and institutions.

According to the author and EU expert, this fluid understanding of risk is crucial. Any fintech regulatory regime that wants to be effective must prove that it can balance the following dynamics:

- Manage the trade-off between efficiency gains arising from technological innovation and the protection of stakeholders in the sector. On the one hand, regulation must not be too stringent to the point it pre-empts the creation and development of new technologies that generate efficiency and savings in transaction costs; on the other hand, regulation must not be too lax in order to ensure that investors and consumers are adequately protected and regulatory frameworks are continuously adapting to technological advances, rather than falling behind the curve.

- Ensure an adequate regulatory level playing field for banks and fintech to achieve appropriate competition, namely:
  - Activities involving the same risks in terms of financial stability, consumer protection and the integrity of the financial system should receive the same regulatory treatment;
  - No unnecessary barriers to competition in the market beyond those justified by risk considerations; and
  - Authorities should further assess the implications of prudential regulation, which often leaves banks in a situation of competitive disadvantage vis-a-vis other players, and work towards eliminating existing loopholes in regulatory frameworks.

- Regulatory frameworks need to be coordinated internationally and upgraded. We do not want to overregulate and must first see whether there is a fundamental economic case for regulating specific products/functions (which in some cases might ultimately be proven useless) and then regulate in a coordinated manner.

## FOOLED BY THE RULE?

If we are to follow Prof Mourmouras' train of thought, this means that there is no 'optimal' regulation for fintech. The most we can aspire to is supervisory oversight – a watchful eye to keep the balance.

Though when it comes to fintech, balanced viewpoints are known to fly out the window on occasion.

Maria T. Vullo, during her tenure as New York Superintendent of Financial Services, issued a statement in August 2018 knocking the idea of a fintech regulatory sandbox. She wrote: "Toddlers play in sandboxes. Adults play by the rules."

Snappy soundbite, but don't knock it till you've tried it. Let's not forget that it was 'ruly' adults, not children, who created that last mess of a financial crisis.

Who's to say that a pact with fintech – virtual 'toddlers' in the financial ecosystem – can't elevate banking to a higher plane?

There will always be dismissive Vullo's among us, hardliners who don't believe in frenemies, who promise that under their world view, the sector will survive.

But survival seems poor consolation when what banking really, really wants…is to thrive. ✱

■ *Julia Chong is a Singapore-based writer with Akasaa. She specialises in compliance and risk management issues in finance.*

BY DR AMANDA SALTER

NOT JUST FOR TREE-HUGGERS

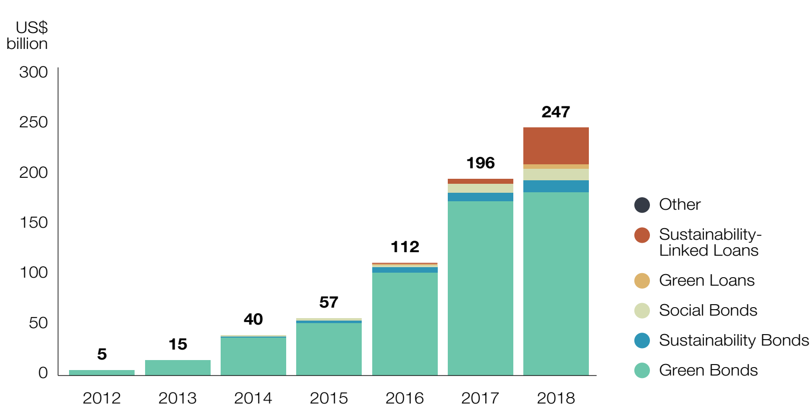
# ASIA'S 'DO-GOOD' LOANS

A slew of news reports indicate ESG loans are gaining ground in Asia Pacific. Here's a primer on sustainability for lenders.

The period from 2012 to 2018 has clearly set out the global growth trajectory in the sustainable debt market (see **Chart 1**).

In the last year, Hong Kong and Japan both established programmes to incentivise market growth, whilst China emerged as a global leader in sustainable debt issuance (US$25.5 billion), second only to the US (US$45.4 billion).

**CHART 1 ANNUAL ISSUANCE OF GLOBAL SUSTAINABLE DEBT**




**SOURCE** BloombergNEF, Bloomberg LP.

The sustainable debt market itself surged 26% in 2018, with a record US$247 billion worth of sustainability-themed debt instruments raised during the year. Of this, US$36.4 billion worth came from sustainability-linked loans – facilities in which the interest rate is linked to sustainability performance targets – which chalked an unprecedented seven-fold increase from the previous year.

This level of growth represents an opportunity for far-sighted Asia Pacific lenders.

A study by the ASEAN–Japan Centre in 2019 found that environmental, social, and governance (ESG) firms in the region were more profitable on average than firms without an ESG thrust, reflected in higher average net profit margins (11.41% vs 9.61%). Leading ESG awareness was concentrated in three industry groups: food, beverage


and tobacco; industrial machinery and materials; transportation. Other industries such as construction, energy, healthcare, media and telecommunications showed increasing awareness of ESG.

## THE LATEST HIGH-GROWTH PRODUCT

Now, let's come back to these sustainability-linked loans.

What exactly are they? 'Sustainable loans', 'sustainability-linked loans', or 'socially responsible loans' are loans structured to incentivise borrowers to improve their environmental, social, and governance performance. Based on a set of pre-agreed ESG factors, if improvements are made by the borrower, this drives a margin ratchet that clicks the loan interest rate down (or up, if performance worsens).

**'Sustainable loans', 'sustainability-linked loans', or 'socially responsible loans' are loans structured to incentivise borrowers to improve their environmental, social, and governance performance.**

Now there's a concept that might send a shiver down the spine of any lender. Why squeeze precious margins 'needlessly'? Haven't we already tried this 'sustainability thing' before? How are these ESG factors measured, and who knows how to measure them?

## ISSUES & CHALLENGES

Historically, socially responsible loans have struggled to take hold in Asia Pacific.

According to *BloombergNEF's* most current figures for 2019, only US$605 million of sustainable loans have been signed in the region, compared with US$4.9 billion in the Americas, and US$15.8 billion in the Europe, the Middle East, and Africa region.

Some of this is attributed to the widespread scepticism amongst financial institutions that sustainable financing corresponds to lower returns.

When sustainability reporting first started in the 1990s, there was little to no support for Asia Pacific lenders; no consistent standards, definitions or guidelines for measuring performance; and a lack of expertise and people on the ground who could quantify what they were doing.

## WHAT ARE ESG FACTORS?

Examples of environmental, social and governance (ESG) factors are numerous and ever-shifting. They include:

### ENVIRONMENTAL

| | | | |
|---|---|---|---|
| Climate change | Greenhouse gas (GHG) emissions | Resources depletion (incl. water) | Waste and pollution |

### SOCIAL

| | | | |
|---|---|---|---|
| Working conditions (incl. slavery and child labour) | Local communities (incl. indigenous communities) | Health and safety | Employee relations and diversity |

### GOVERNANCE

| | | | |
|---|---|---|---|
| Executive pay | Bribery and corruption | Board diversity and structure | Tax strategy |

ESG integration in Asia Pacific has never been a formal requirement by regulators, as opposed to

European regulations which require certain banks to channel some of their capital into green lending. Asia Pacific participation to date has been voluntary and with the burden of complying with regulators getting heavier all the time, it's understandable that it wasn't quick on the uptake.

It's unfortunate that in some instances these factors led to the practice of 'greenwashing', where ethics and sustainability became mere marketing checkboxes instead of being applied as true guiding forces. Add all this and it's no surprise that sustainable loans were not a major success.

But the signs of a sea change are on the horizon.

## CHASING HIGHER PERFORMANCE

A plethora of research dating back to the 1990s have consistently declared that sustainable financing did not in fact lead to lower returns.

A 2015 paper by Friede, Busch & Bassen on *ESG and Financial Performance: Aggregated Evidence from more than 2000 Empirical Studies,* published in the *Journal of Sustainable Finance & Investment,* claims that 90% of studies showed either a positive relationship between ESG integration and corporate financial performance or at least a non-negative relationship.

"Performance of selected sustainability indices has been largely on par with benchmark indices over different investment horizons," write *FT* in its September 2019 feature, *Asia has a Crucial Role to Play in the Development of Sustainable Finance.*

A recent case in point, when Sydney Airport signed an AUD$1.4 billion syndicated sustainability-linked loan in May 2019 – the biggest of its kind thus far in the region – Gavin Chappell, ANZ Head of Loan Syndications, said "the loan was well received by lenders and the significant demand helped Sydney Airport achieve a competitive margin."

If all this is true, then ESG is not just for tree-huggers but also for those chasing higher financial performance.

ESG factors can also help lenders to make better decisions, particularly regarding a borrower's credit risk. "There is growing acceptance by lenders that companies' ESG performance translates into better share performance and ultimately better credit risk," said Chris Ruffa, Managing Director for Energy and Infrastructure at BNP Paribas SA.

A recent Wharton study, *ESG, Material Credit Events, and Credit Risk,* has empirically proven the link between ESG factors and credit risk. The July 2019 paper, the first large-sample empirical study of mechanisms that link ESG performance to credit risk, scored timely and material events such as regulatory inquiries, investigations and lawsuits, which are correlated with credit risk and the likelihood of default.

Henisz and McGlinch, the authors of the Wharton study, surmised "clear evidence that higher-performing companies on ESG criteria experienced subsequent lower incidence of adverse material events. Companies with lower performance relative to their peers in their industry based on material ESG criteria as defined by the Sustainability Accounting Standards Board, experienced a higher incidence of adverse material events."

Financial institutions are therefore now starting to incorporate ESG factors into their credit risk calculations, including Malaysian credit rating agency RAM's efforts to create a 30-factor ESG thematic risk assessment matrix.

But funding gaps exist. The International Finance Corporation,

a member of the World Bank Group, provides some clues of its estimated size.

In the 21 emerging markets analysed, projections show that bank lending needs to increase from US$1.5 trillion to at least US$13.3 trillion in the area of climate-related lending alone, between now and 2030. Within this, the East Asia and Pacific group of countries is expected to have the highest demand for lending: China, Indonesia, Vietnam, and the Philippines.

## COMMON SENSE

Good governance as a matter of common sense leads to better management of an organisation and thereon to improved performance and less risk overall. For all these reasons, boards are starting to demand an increase in the amount of lending linked to sustainability objectives.

This year, 15 banks in Thailand committed to responsible lending by integrating ESG factors into their loan approval decisions through a Bank of Thailand initiative.

Shareholders are no less demanding either. Banks are facing growing shareholder pressure to increase allocations to the ESG asset class.

Robert Eccles, Visiting Professor of Management Practice at Oxford University's Saïd Business School, emphasised in a May 2019 interview with *Harvard Business Review:* "…progress on ESG isn't just a nice-to-have anymore. It's something shareholders will demand, because they believe it's going to drive everything else they care about. Growth, market share, profitability. So, for any company keen to attract capital, sustainability has to become a focus."

There is also a growing trend among borrowers who want to align their ethical values to their cost of borrowing. ESG loans are more flexible for borrowers than green loans – they can be used for general corporate purposes instead of only for green projects. Therefore, ESG loans are more interesting to corporate borrowers whose main business concerns don't include green projects.

What else is changing? Well, there are now new guidelines available to help support integration of ESG factors into lending. The Asia Pacific Loan Market Association and partners have published *Sustainability Linked Loan Principles* to help promote development and preserve integrity of sustainability-linked loans by providing guidelines which capture their fundamental characteristics. A corresponding set of Green Loan Principles is also available.

Looking more widely at sustainable finance, the United Nations has published a set of Principles for Responsible Investment (UN PRI). Current asset under management by UN PRI signatories totals almost US$82 trillion, reflecting the global trend toward ESG.

Its signatories include Malaysia's trillion-ringgit Employees Provident Fund; the nation's government investment arm, Khazanah Nasional; and other value-driven institutions such as Bank Islam Malaysia. This solidifies the view that when adopted, sustainability guidelines like UN PRI can help create consistency across the market, making it easier to assess debt instruments, build confidence, and enable markets to develop.

The best evidence of change is, of course, actual successful sustainable loan deals. There have been a number of high-profile sustainable loans transacted recently.

This shows that mindsets are truly transforming.

## YOUR OPPORTUNITY, IF YOU CHOOSE TO ACCEPT IT…

Lenders should get their ducks in a row and be ready to grab a slice of the emerging sustainable debt market in Asia Pacific.

There is potential to attract borrowers who are already actively seeking loans that align with sustainable values. Adding more environmentally and socially conscious loans to the balance sheet will help lenders to meet shareholder and borrower demands for sustainability.

Successfully integrating ESG into decision-making and being able to offer sustainable loan products will give faster-moving lenders competitive differentiation, strengthen their position, and prove their ability to innovate and adapt to meet market changes. Credit risk models will also benefit from improved lending decisions.

Banks in Asia Pacific need to make a choice – stick with the status quo and wait to see what happens, or get ready to grasp the new challenges and opportunities of sustainable lending before the market matures, because all these signs are saying it will. ✱

■ *Dr Amanda Salter is Principal Partner for CX-led content design at Akasaa. Based in Newbury, England, she holds a PhD in human centred web design and BSc (Hons) in Computing Science.*

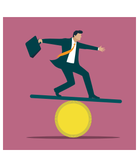
BY ALEX WEST

# WHY EFFECTIVE DETECTION OF MARKET ABUSE REQUIRES A TRADER-CENTRIC VIEW

MOVING TO A MORE EFFECTIVE RISK-BASED APPROACH IN SURVEILLANCE.

Some of the fundamental problems with detecting market abuse stem from the siloed view that most organisations have to contend with when performing surveillance. People commit market abuse. Yet, most surveillance approaches take a transaction-centric view where alerts are generated based on rules-based triggers with little regard to the motivation or intent of the individual traders. Behavioural approaches have long been an aspiration. Technology has now caught up with aspiration and a trader-centric approach is an achievable possibility. A trader-centric view would significantly enhance the ability of analysts to link isolated occurrences into patterns of behaviour and deliver more effective surveillance.

Compelling efficiencies could be achieved by taking this a step further and applying an integrated and risk-based approach. The current lack of appreciation of how alerts relate to behaviour in turn leads to a situation where every alert is treated as equally valuable. A risk-based approach would enable surveillance teams to discriminate between very strong indicators of market abuse and very weak indicators. Consequently, surveillance teams could review alerts in priority order or assign more experienced hands to alerts representing greater risk. Considering that surveillance solutions generate a very high number of 'false positive' alerts – PwCs *2019 Market Abuse Surveillance Survey* indicates that 99.9% of alerts were deemed 'false positives' by surveyed banks – it is apparent that a risk-based approach could deliver considerable efficiencies while also allowing effort to be focused on areas of greater risk.



**+ Compelling efficiencies could be achieved by taking this a step further and applying an integrated and risk-based approach. The current lack of appreciation of how alerts relate to behaviour in turn leads to a situation where every alert is treated as equally valuable.**

### TAKING A TRADER-CENTRIC VIEW

Differing surveillance approaches for different markets and asset classes are unavoidable. For the vast majority of market participants, data volumes will necessitate technology-based surveillance approaches. Manual surveillance, generally, can't hope to provide adequate coverage of anything but the lowest volume businesses.

Most firms have implemented multiple trade surveillance technologies tailored to provide coverage of their different business lines and product areas. Electronic communications (eComms) and audio communications (aComms) surveillance systems sit alongside, but rarely link to, trade surveillance solutions. While some vendors are now offering tools that bring together elements of trade and eComms surveillance, these are not yet widespread. The abovementioned PwC survey indicates that banks have an average of between three and four different surveillance technologies in place.

This has led to a situation where alerts relating to the same trader are generated in different systems and reviewed by different analysts who may not be in the same building, or even on the same continent. This makes it harder for the surveillance analyst to understand the context of an individual alert, at best leading to the need for increased review time to manually piece together data during an investigation, and at worst making it impossible to effectively assess whether the alert is indicative of market abuse or not.

Some firms have structured their surveillance teams to try to make joining the dots easier: surveillance analysts have been grouped into product-focused teams so that trade and eComms alerts relating to the same group of traders are reviewed by one team. While this has undoubted benefits, organisational integration can only go so far to support analysts' identification of connections between the blizzard of alerts they need to review every day. Alert volumes are very high – 21 banks surveyed by PwC generated 40 million alerts across trade and eComms in a

**Some firms have structured their surveillance teams to try to make joining the dots easier: surveillance analysts have been grouped into product-focused teams so that trade and eComms alerts relating to the same group of traders are reviewed by one team.**

year – and it is evident that manually joining the dots between alerts is not straightforward.

Data volumes necessitate a technology solution to integrate surveillance alerts. Bringing all surveillance alerts together into a single analytical environment, enriched with organisational and market data, and applying a behavioural lens through the use of risk-based models would better enable organisations to target areas representing greater risk and deliver review efficiencies.

Behavioural models need not be highly complex. More data does not necessarily mean more insight in this context. Firms that have sought to build behavioural models that integrate diverse data sets such as profit and loss (P&L), risk-limit breaches, training completion and building access data, for example, have struggled to correlate data sets with actual behavioural indicators. It doesn't always follow that someone working late is doing something wrong. Someone who has failed to complete the training on time is not more likely to abuse the market. Whereas surveillance systems currently only consider point-in-time events and apply generic thresholds, an integrated view of historical data would enable more dynamic time series and trend analysis to detect patterns of behaviour for an individual over time. Alerts could be generated based on longer term patterns of behaviour that individually may not cause concern because they fall outside of parameter thresholds, but together may indicate risk.For example: Has a trader regularly had spoofing alerts at month ends that have been individually closed as 'false positives', but which together indicate a pattern of attempts to boost financial performance before month-end P&L cut-off?

## ALL ALERTS ARE NOT EQUAL

As well as enabling a trader-centric analytical overlay, a single surveillance alert environment could

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be used to determine the relative risk represented by each alert. Machine learning provides an opportunity to develop models that automate risk-scoring of alerts to provide a predictor of likely risk. While this could be achieved within point-solution silos and without a trader-centric view, risk-scoring combined with a behavioural lens would create far greater scope to align risk scores to the actual perpetrators of market abuse, i.e. individuals.

Machines need a back book of 'true positives' to build effective risk-scoring models. Organisations need to capture historic outcomes of their alert review process to develop a picture of the characteristics that make an alert more or less relevant. Historical alert data, when tagged with review outcomes, could be used to train models to prioritise individual alerts based on likeliness to escalate. This could be combined with a trader-centric view and with behavioural alerts that consider patterns in surveillance alerts for a trader over time. Tying the data together could help to reduce the noise and focus on what is genuinely interesting.

The logical outcome of a trader-centric and risk-prioritised alert population would be to focus the review on higher risk traders and higher risk patterns of alerts. Ultimately, more time would be spent deliberating a smaller number of higher quality alerts.

## START NOW AND INTEGRATE LATER

Pressure on surveillance budgets is likely to be a key driver for change. A paradigm shift will be required to move away from the current approach where a huge amount of effort is expended reviewing benign trading behaviour. This will require firms to break the current equation where additional surveillance always translates to a greater volume of alerts, a greater volume of 'false positives', and increased surveillance costs. In a utopian integrated surveillance future, investment in surveillance will mean more effective identification of risk.

**Pressure on surveillance budgets is likely to be a key driver for change. A paradigm shift will be required to move away from the current approach where a huge amount of effort is expended reviewing benign trading behaviour.**

Of course, such a change will not be easy or immediate: Disparate and incompatible data, limitations to existing technology, data latency and accessibility will all be barriers to the effective integration of surveillance data, and will take time to resolve. There is complexity even in the apparently simple: Creating a trader-centric view means that each transaction needs to be attributed to a trader. That is not straightforward where books are shared, trades are recorded by middle office and trader IDs are not consistent across systems. But these are not insurmountable problems; time and investment now will pay off with efficiencies in the future. Organisations need to start work to progress data cleansing and to build up a sufficient back-book of review outcomes to inform a risk-based approach in the future.

In parallel, the industry as a whole needs to collaborate and engage with regulators to build consensus around the efficacy of risk-based approaches. Organisations in developing markets, where regulators so far have been less prescriptive about surveillance requirements, have an opportunity to leapfrog development and move to more effective risk-based approaches in quicker time. This can be harder in more developed markets where changing approach and looking at fewer alerts (albeit higher quality alerts) will require more work to reassure stakeholders that models effectively identify risk. ✱

■ *Alex West is a Director at PwC, and Misconduct and Market Abuse Surveillance Specialist.*

BY DEREK ARISS

# CREATIVITY MINDSET IN BUSINESS: THE NEXT COMPETITIVE EDGE

*Getting your mind to look at more.*

Technology is driving change at an ever-increasing rate. So quickly, in fact, that as businesses and individuals, we need some skills that will allow us to thrive in these ever-changing times. One of these skill sets lie in the area of creativity We've often heard about the need for organisations to be more creative, both as a strategy and an operational tactic. But what does this mean?

If we look back on the past 100 years, civilisation has been continuously improving. We have gone from the industrial age, where the ability to build products was the competitive strength, to the information age, where information and data analysis will be the competitive advantage for organisations. However, the next age that will provide a point of difference will be the age of creativity, where ideas that add value to our businesses in new and productive ways will be the hallmark of success.

Creativity and, for that matter, innovation seem to be at the heart of this opportunity list.

In this article, we will present a cross section of information on creativity, why it is vital in business, how all of us have tremendous creative ability and how we can start to apply it daily in our work and personal lives.

## DEFINING CREATIVITY

Creativity in this article is seen as the ability to use our minds and imagination to create something new and add value to the world. Often, we use creativity to

identify new opportunities, find new solutions or look for new approaches. We use this skill set more often than we think, and it gives businesses a competitive advantage. Without creativity in business, Henry Ford would have no assembly line, Nikola Tesla would not have imagined electromagnetic waves (electricity), and Elon Musk would not have been involved in PayPal, let alone look at autonomous vehicles and colonising Mars. Interestingly, this ability to use our minds to think of new and valuable things is not there for only a few people…it exists and is latent in most of us. As a first step, all we need to do is learn how to tap into this ability. But before this…do we think creativity is important in business?

Aside from my view, there is a reasonable amount of research that show we all seem to agree that creativity in business is important. That and a little more.

An Adobe systems poll, surveying over 5,000 people across three continents, showed that 80% of people surveyed saw the need to unlock peoples' creative potential as a key for economic growth. In addition, less than a quarter of those people surveyed found that they were using their creative skills sufficiently to meet their creative potential. In summary, creativity is important, yet we don't seem to use it enough. The good news is that this means we have lots of upside to develop.

The Adobe findings pair up with what I experienced when running creativity and innovation workshops.

Often, I will ask participants three 'yes or no' questions related to creativity:

1. Do you feel that creativity is important in your business (the majority of participants say 'yes').
2. Do you think that you are creative (about a 50/50 split).
3. Do you feel that your organisation or company is doing enough to be creative (a minority say 'yes').

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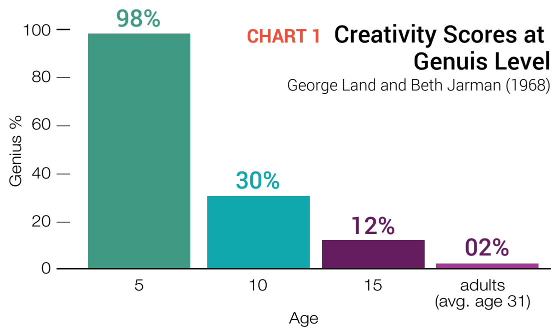
Admittedly, it's not an Adobe or Michigan Institute of Technology study yet, but the pattern is consistent across several years of workshops…and yes…I will need to conduct a formal survey sometime soon.

Having said this, there are three very positive takeaways:

1. We believe creativity is an important skill.
2. There is an upside in people being able to use their creative skills in business.
3. There are tremendous opportunities for businesses to learn about, apply and benefit from developing creative skills.




There often comes a point where people tell me, "Well some people are just naturally creative, and others aren't. How do we identify the creative ones?". You'll be surprised to learn that most of us have tremendous creative capabilities.

## ARE WE ALL CREATIVE? THE NASA CREATIVITY TEST AND FIVE-YEAR-OLDS

In 1968, the National Aeronautics and Space Administration (NASA) hired a psychologist by the name of Dr George Land to do a study on their top engineers. The objective was to identify which of their engineers were the most creative, and in turn could solve problems in a creative way. They needed these people to work on challenging problems and to take their projects to a new, higher level, the type of people who could resolve critical issues creatively. Dr Land conducted the study and found that the creativity test was simple enough that he could administer the test to children.

In fact, he did administer the test to a group of five-year-olds. The results were interesting. Dr Land found that 98% of the children fell into the Creative Genius category! Even more interesting was that five years later, the test scores on the children changed dramatically.

Only 30% of those same children fit into the Creative Genius category. Another five years later, this dropped to 12% and then to 2% at the age of 31.

Dr Land believed something in our education system curbed creativity.

Interestingly, this message is similar to one of the world's most highly watched Ted Talks, with over 56 million views. This talk is by Dr Ken Robinson entitled "Do Schools Kill Creativity" delivered in 2006.

The good news is that we all can reignite creativity within ourselves and our teams to solve problems, and in turn, create better products and/or services.

For this article, what is worth noting for business is all of us have had the ability to create, and we need to find ways of tapping into this once again. We need to relearn the fundamentals.

Creativity and innovation are like muscles: As they get used regularly, they grow. And this is where a lot of potential lies for businesses.

## COMBINING IDEAS TO CREATE NEW IDEAS

Let's take a look at one very effective way of developing ideas and how we can exercise this to generate some creative ideas in your business. It is a very basic and powerful way of being able to create ideas.

I first ran into this idea at an innovation conference a few years back, and then discovered that it is one of the quickest and simplest ways to start looking at creating ideas.

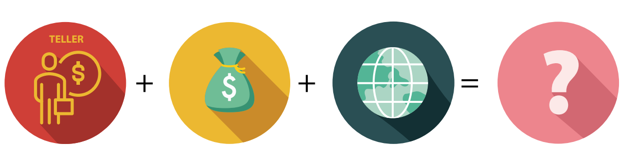
The basis is you take two unrelated ideas – let's call them idea 1 and idea 2 – and you combine them in unrelated ways. For example, you take the idea of a cake (idea 1), and the idea of chocolate (idea 2), and you combine them…what do you get?

Yes, most of you would have said 'chocolate cake', and would have done this quickly. Easy right? But what if I said, "That's perfect, now come up with 10 to 20 different combinations", you would find that the results would take more time…and you would begin to get some interesting ideas, e.g. chocolate that tastes like cake, baking flour with cocoa, chocolate in the shape of a cake…you get the idea.

This process can also be applied in business to discover creative solutions.

For instance, let's look at a more financial-services-related example. Instead of two ideas combined, let's make it exciting and combine three ideas.

Take the ideas of a teller (idea 1), of money (idea 2), and the world (idea 3). See how many ways you can combine these to create great ideas.




If you want some practice, spend three minutes and come up with 20 ideas that combine these ideas. Don't look at some of the ideas below. Have you thought of some ideas? Excellent. I suspect some interesting results that you may have come up with looked like this:

- SWIFT;
- electronic transfers;
- ATMs;
- mobile banking;
- digital currencies; and
- credit cards.

The list goes on.

It is the power of looking at these combinations that create opportunities for new products and services. However, we don't spend enough time practicing these skills or time to think about the possibilities of ideas…even though we all have the potential to deliver great ideas.

Now, let's look at how time can play a role in the creation of new ideas.

## THE CONCEPT OF TIME IN IDEA CREATION

We as business people behave in a very patterned way and seem to be time-poor. What if you and I were having coffee and I asked you to look at a set of information and come up with the answer to this sequence.


I suspect most of you would answer 4 and do so in a matter of seconds. We would look at this sequence and automatically infer the correct answer. An answer which a majority of people would agree and deem to be the right and only answer. However, from a creative standpoint, there is no one answer, but an infinite number of organisations.

For example, the answer could

be 6, 9, or many other solutions. Remember, this is an article on creativity:

1 + 2 + 3 = 6

(1 + 2) x 3 = 9

1 2 3……………. GO!

Generally, when people are asked to solve problem, they tend to:

a. answer the question very quickly;
b. answer the question as if there were only one answer; and
c. answer the question as if only one answer were correct.

To find creative solutions, we need to:

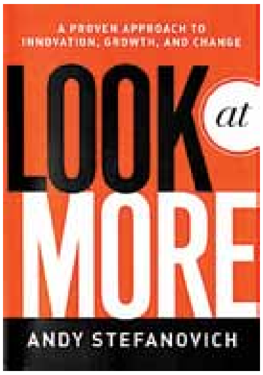
a. take time to look at possible answers;
b. know that there are always multiple answers; and
c. accept that many answers can be correct.

Then we will be on our way to getting our minds ready for creativity.

## HOW TO FIND NEW IDEAS FOR PROBLEMS

So how do we work on improving our creativity in business? One of the easiest ways of bringing creativity and ideas into a business is to go out of the business and try something new. Try it today! The novelty of the activity will give you exposure to different angles and points of view and get you comfortable with creative solutions.

I often encourage clients and bring people to the Red Dot Design Museum (if you are living in Singapore). It is a collection of the best designs from around the world on display in one small building. In an hour walkabout, you get to see award-winning innovations and designs across all industries from mobile phones, jewellery, tech,




construction, entertainment…you name it, it's there.

It is so easy to get to. In most cities, there will be some space in which you can easily have access to have an hour of exposure to new things. You have to look.

But you don't need to go to a museum, just go and do something out of your norm. Try a new restaurant, surf the net with your kids, go for a walk instead of a drive…it doesn't matter, do it!

And here is the important part:

After the experience, note down what was novel, interesting, and/or unexpected…and apply it to a problem you are trying to solve.

If you do this in business, chances are you will find an exciting and valuable solution to the next problem you are working on. It's a simple and powerful technique. One of my favourite books that embrace going out and experiencing new things is called *Look At More* by Andrew Stefanovich. The book is about innovation, and has a number of creative concepts and case studies. As leaders, it reminds us on how we need to lead by example and help our teams create. And to create great solutions, we need to get out of our offices and look at more. Doing this will bring more creativity to our business. It is a great read.

## SUMMARY

So, there you have it, a cross-section of information on creativity in business: Why it is crucial, how all of us have tremendous creative ability and how we can start to apply it daily, professionally and personally.

I hope you enjoyed the read as much as I enjoyed writing the article. ✱

■ *Derek Ariss is Head of Innovation Education at Lightbulb Capital and is responsible for building the education practice, focusing on creativity, design thinking, technology, culture, and mindset conducive to innovation in finance. He previously guided the company as an Advisory Board Member to Lightbulb Capital Pte Ltd. Before his current role, Derek was the Head of Innovation at LendLease. He was responsible for designing processes to deliver improved products and systems, nurturing a culture of innovation in Asia, and developing productive relationships with organisations that focus on innovation and growth. Before his position as Head of Innovation, he was Head of Retail Operations overseeing the retail assets managed by the company across Asia. Derek also teaches part of the Singapore Management University (SMU) Certificate in FinTech and Innovation course and an Innovation Culture Catalyst course at SMU. He holds an MBA in International Marketing and Strategy and Bachelor of Commerce (Honours) from the University of Windsor, Canada, and a Bachelor of Science in Psychology and Biology.*

BY PERBADANAN INSURANS DEPOSIT MALAYSIA (PIDM)

# culture in governance matters

## CULTURE VERSUS INSTITUTIONAL DESIGN

Independent board members, aligning pay incentives, internal controls, risk management, and so on. These corporate governance arrangements are no longer new concepts. Since the Cadbury Report in 1992, there have been innumerable publications, codes and laws on this subject.

Yet, despite these guides and exhortations, we continue to witness corporate scandals – Enron, WorldCom, Countrywide Financial, VW, Wells Fargo, to name a few. The 2008 global financial crisis exposed massive failures of ethics and leadership in finance, business and government.

## CONDUCT AND ETHICS

The consensus is that many of these issues boil down to the lack of a culture of ethical behaviour. Many employees within organisations that purportedly subscribed to 'best practice' in governance, were in fact living a different ethical culture. They role modelled after their leaders. They were driven by the wrong incentives or they may have operated under undue influence.

In 1994 when the UK Nolan Committee published the *Seven Principles of Public Life,* the principles were considered "revolutionary" simply because the focus of the discussion was on behaviour and culture, not on process.

Today, the expectation of corporate boards to play an active role in ensuring corporate culture is explicit. The UK Corporate Governance Code, for example, states that the board is to assess and monitor culture. The ASX's Corporate Governance Principles and Recommendations requires the board charter to include the role of the board to approve the entity's statement of values and code of conduct to underpin the desired culture within the entity.

## THE CHALLENGE

The reality is that ethics and integrity have always been part of the governance conversation. A significant challenge is that ensuring this "culture" is impervious to implementation and measurement.

In the financial services world, at least we are beginning to see this change. In 2015, the Group of 30 published the *Banking Conduct and Culture:A Call for Sustained and Comprehensive Reform,* reflecting a global regulatory agenda to pin down this slippery issue of culture. What is interesting is that regulators today have begun to use behavioural science to assess how institutions are treating consumer interests. An international survey has reported that 25 regulators from across the world are now using behavioural tests to check on customer

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outcomes. This is with the view to assess, understand and influence behaviour, so that they may achieve a greater impact on culture within organisations.

De Nederlandsche Bank, the Dutch central bank – now widely regarded as a leader in the supervision of conduct and culture – has established a comprehensive supervisory framework on behaviour and conduct. It has even placed organisational psychologists to observe boards and management in order to assess their regulatees' organisational culture. The UK Financial Conduct Authority published a series of discussion papers on the very topic of transforming culture in the financial services. Supported by the Dutch central bank, the Irish Central Bank published the findings of its assessment of the conduct and cultural review of five large Irish retail banks. In April 2019, the International Organization of Securities Commissions issued a report on how financial regulators around the world are using a "culture measurement" to question customer outcomes.

**Opening of conversation on culture in the global regulatory agenda signals the preparedness of regulators to change the old approach.**

## GOVERNANCE AND CULTURE IN THE PUBLIC SECTOR

Opening of conversation on culture in the global regulatory agenda signals the preparedness of regulators to change the old approach. At the same time, the conversation about culture has not stopped at the culture of regulatees.

A challenge of framing the public sector's culture relates to finding the right balance between getting feedback and 'undue' influence from the many stakeholders with diverse interests.

According to the Organisation for Economic Co-operation and Development (OECD), 'governance' for regulators "…helps ensure that regulatory decisions are made on an objective, impartial and consistent basis, without conflict of interest, bias or improper influence." The OECD observed, "What distinguishes an independent regulator is not simply institutional design. Independence is also about finding the right balance between the appropriate and undue influence that can be exercised through the regulators' daily interactions with ministries, regulated industries and end-users."

Achieving that 'right' balance is in some cases clearer than others. The ongoing Boeing 737 Max saga is a case in point. The failure of safety checks on the plane model resulted in two fatal crashes and the deaths of a total of 346 people. This has raised questions about the competence of the Federal Aviation Administration (FAA) responsible for safety oversight. The other significant question is this: Did the FAA suffer from excessive industry influence when it certified Boeing 737 Max as safe? A look into its history reveals that this issue is not new to the FAA. In 2008, the Congressional Committee on Infrastructure and Transportation criticised it for being too close to the industry it regulated.

The global financial crisis also highlighted the problems that arise when regulators insufficiently challenge the prevailing thought of the sector it regulates. To counter this, some financial regulators incorporated independent units within their own organisations to reduce the influence of unconscious cognitive biases in their thinking.

Even as such developments have taken place, regulators are also subject to scrutiny. In October 2016, for example, a not-for-profit think tank, New City Agenda, published a report titled *Cultural Change in the FCA, PRA and Bank of England: Practising What They Preach?*. This report set out to examine what the UK's financial regulators – the FCA, PRA and Bank of England – have done to change their own culture following the 2008 financial crisis.

## CONCLUSION

It is clear that behavioural studies and the use of behavioural tools are increasingly seeping into the thinking of regulators around the world. As evident from the Boeing 737 Max case, the culture of regulators themselves are also important matters to consider. Much as there is an expectation for leaders within those organisations to role model desirable conduct, there is also an expectation for public sector bodies to do the same. ✱

■ *PIDM is a statutory body that provides protection against the loss of deposits and insurance or takaful benefits with its member institutions in the event of a failure. As an integral part of the national financial safety net, PIDM promotes and contributes to the stability of the financial system.*

# THE COST OF GOING CASHLESS

Cash needs to stay core to life in the UK – or millions could be excluded. Natalie Ceeney CBE shares her thoughts on the Access to Cash Review.

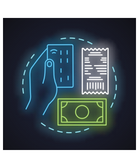
Is Britain ready to go cashless? And if not, given the trends towards digital payments and away from notes and coins, how do we ensure that no one gets left behind?

These two key questions shaped the final report of the *Access to Cash Review,* which was published in March 2019 to examine the future of physical money across the UK.

Natalie Ceeney CBE, the former head of the Financial Ombudsman Service, led the review, which was set up amid concern about ATM accessibility and startling statistics showing declining cash use in Britain.

"Almost every day there is another story in the media of bank branches and rural ATMs closing, or pubs, restaurants, charities and shops going cashless," Ceeney says in her foreword to the final report.

"10 years ago, six out of every 10 transactions were cash. Now it's three in 10. And in 15 years' time, it could be as low as one in 10."



**+ "10 years ago, six out of every 10 transactions were cash. Now it's three in 10. And in 15 years' time, it could be as low as one in 10."**

## FINANCIAL EXCLUSION

The review found that around 17% of the UK population – more than eight million adults – would struggle to cope in

We found that this was more about need than choice – for many, digital payment options just don't yet work for them," Ceeney told *Chartered Banker* magazine. "And we found that this was far from being restricted to the old. Poverty is the biggest indicator of cash dependency, not age. And for many, the lack of universal broadband and mobile connectivity simply means that digital payments aren't possible.

a cashless society.

"We found that this was more about need than choice – for many, digital payment options just don't yet work for them," Ceeney told the UK's *Chartered Banker* magazine. "And we found that this was far from being restricted to the old. Poverty is the biggest indicator of cash dependency, not age. And for many, the lack of universal broadband and mobile connectivity simply means that digital payments aren't possible."

Excluding this many people from being able to pay for goods and services in cash would cause myriad problems. The viability of rural communities would be threatened, there would be increased risks of financial abuse and debt and the prospect of loss of personal independence.

"We don't believe that leaving this many people behind in a rush to a cashless society is an acceptable outcome for Britain, and it's also not what the majority of the people of the UK want," Ceeney says.

## TAKING ACTION

To avoid this scenario, the final *Access to Cash* report proposes a set of recommendations – for the government, for regulators and for banks. They are:

01 Guarantee access to cash
02 Ensure cash remains widely accepted
03 Create a more efficient, effective and resilient wholesale cash infrastructure.
04 Make digital payments an option for everyone
05 Ensure joined-up oversight and regulation of cash.

If we think this way, we can envisage more radical solutions to keep cash viable. For consumers, we believe it's both sensible and commercially viable for the banks and regulators to offer a 'guarantee' of cash access – in part by encouraging innovative ways of accessing cash, rather than just protecting increasingly unviable ATMs or, worse, charging consumers for access.

"One of our core conclusions is that we need to start considering cash to be a core part of Britain's national infrastructure, and not as a simply commercial issue," Ceeney says. "If we think this way, we can envisage more radical solutions to keep cash viable. For consumers, we believe it's both sensible and commercially viable for the banks and regulators to offer a 'guarantee' of cash access – in part by encouraging innovative ways of accessing cash, rather than just protecting increasingly unviable ATMs or, worse, charging consumers for access.

"To protect cash acceptance, we believe that if we can help the banks keep the costs of cash down as its use declines, and to innovate around cash deposit solutions, then there will be few commercial incentives for retailers to stop taking cash.

"And, underpinning all of this, we believe that a 'utility model' – namely a joined-up wholesale cash infrastructure – could significantly reduce the costs of running the cash infrastructure – making cash commercially viable for the banks to fund on an ongoing basis."

**In fact, around half of Swedish retailers say they probably won't accept cash after 2025. The real death knell for cash in Sweden was likely to be retailers and service providers refusing cash, not the loss of ATMs and bank branches.**

## GLOBAL LESSONS

As part of the review, Ceeney and her team visited Sweden and China, two of the most cashless societies globally, to understand the challenges of reducing cash in society, and the actions they were taking.

In Sweden, cash use has fallen to just 15% of all payments, compared

with 34% in the UK.

"Issues arose in Sweden when hospitals stopped accepting cash," Ceeney explains. "In fact, around half of Swedish retailers say they probably won't accept cash after 2025. The real death knell for cash in Sweden was likely to be retailers and service providers refusing cash, not the loss of ATMs and bank branches. This is causing real concern and questions about how to maintain key services for those who can't or won't go cashless. The Riksdag (Swedish parliament) has agreed that the cash infrastructure must not be allowed to disappear before parliament is satisfied that no societal detriment will arise."

In China, cash use has declined 10% over the last two years and ATMs have plummeted, with 100,000 closures anticipated by 2023. Mobile payments have reached ubiquity, with 92% of consumers using the mobile and online payment platforms Alipay or WeChat Pay as their primary payment method.

"Interestingly, innovation is playing a role," Ceeney says. "Alipay has developed biometrics as a payment tool to overcome literacy issues: everyone's smile is unique, so people can pay for goods by smiling at a camera.

"However, China's central bank has had to remind merchants that it's illegal to reject cash as a payment method. The bank believes that not accepting cash could lead to loss of confidence in cash and be unfair to those who aren't used to electronic payments." ✱

■ *This article previously appeared in the Chartered Banker magazine, UK, summer 2019 edition.*

## Elders' Access to Cash

Older people are highly dependent on cash for daily purposes and for paying people who do work or shopping for them, according to research from The Finance Foundation.

In its submission to the Treasury Committee's inquiry into *Consumers' Access to Financial Services,* the independent think tank argues that those in later old age (aged 80 and over) are now at high risk of financial exclusion.

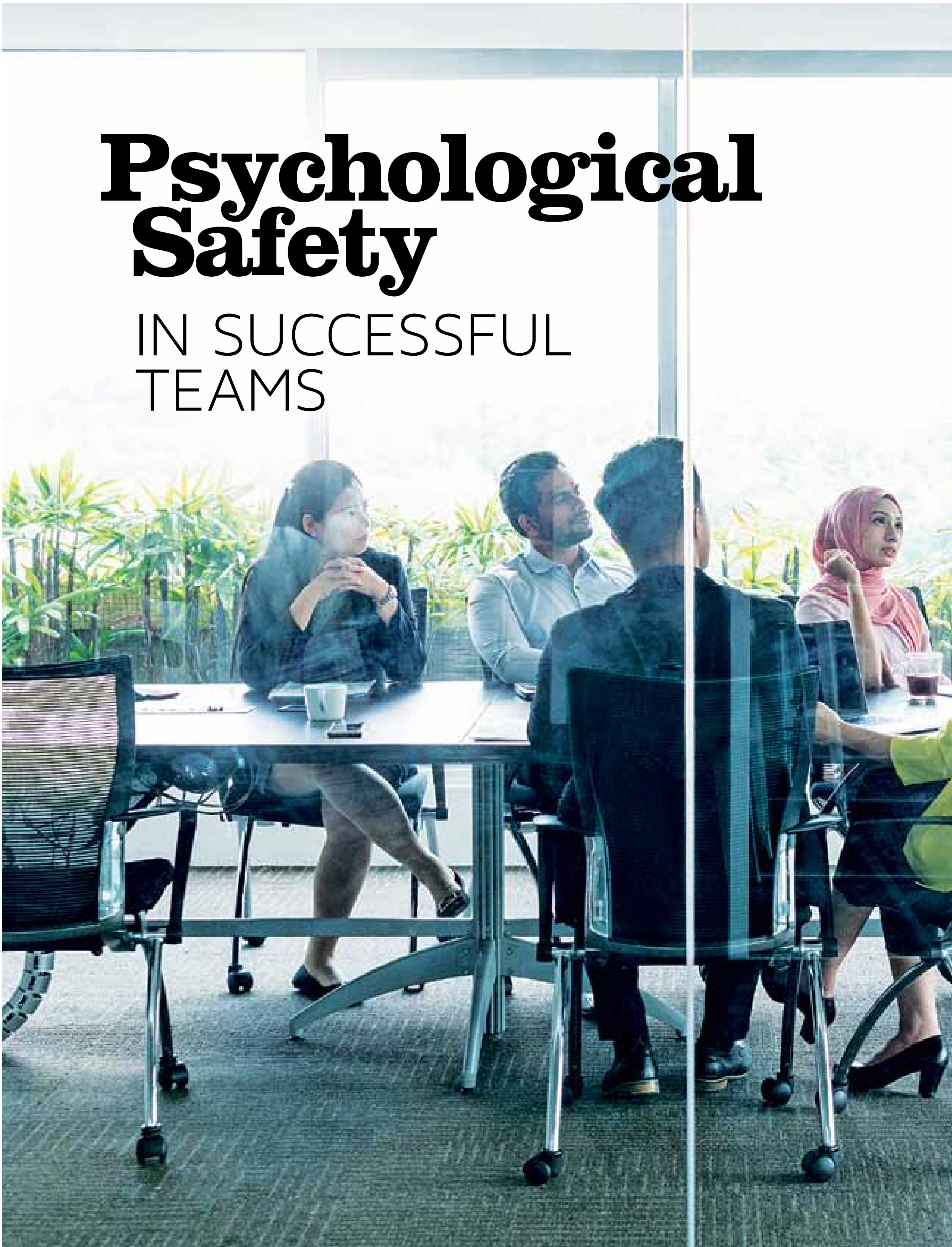
"Our research on older people found both a strong preference for cash and for face-to-face interaction as part of their day-to-day banking," explains finance expert and Finance Foundation Senior Associate Hilary Cooper, who wrote the submission. "There is also a dislike and disinclination to use technology for a whole variety of reasons, including physical and cognitive challenges and fears over security, theft and mistakes."

The ability to access money and have an effective means of paying for life's necessities must be understood as being as fundamental as the ability to continue with basic functions such as washing, dressing and eating.

"If we do not find a way of ensuring that older people can carry out routine financial transactions, even if it is as simple as paying a neighbour for shopping, then all the other support we provide to them with other daily tasks may not in the end be sufficient to enable them to continue to live independently," Cooper adds. "If this ends up pushing people into earlier than necessary institutional or other dependency, it will be costly for them, costly for their relatives and costly for society as a whole."

# Psychological Safety

## IN SUCCESSFUL TEAMS



Psychological safety describes a group environment where individuals are not hindered by interpersonal fear. Team members aren't afraid to speak up. They're not afraid to take risks when it comes to raising any concerns or sharing ideas. And you'll find that leaders and peers in a team with high psychological safety also have the courage to listen to perspectives that differ from their own.

**Nicole Brigandi**

Team members who are **empowered to share ideas, take risks and be themselves** are top performers enjoying a culture of psychological safety. Firms who ignore this concept do so at their peril.

There's a leading predictor of high-performing, healthy teams and organisations, called 'psychological safety'. It's the ability to question, speak up, and most importantly, listen up to challenging or different views. It's one of the factors helping some banks consistently outperform the market, while others that don't take time to cultivate it are more susceptible to major breaches of conduct.

In a member webcast, the Chartered Banker Institute explored the concept of psychological safety with organisational psychologists Abigail Freeman and Nicole Brigandi.

"Psychological safety describes a group environment where individuals are not hindered by interpersonal fear," explains Brigandi, who is also a leadership coach. Brigandi recently worked with the Financial Conduct Authority (FCA) to engage the industry in a dynamic dialogue on creating healthy culture in firms, including how to encourage a 'speak up, listen up' mindset in financial services.

"Team members aren't afraid to speak up. They're not afraid to take risks when it comes to raising any concerns or sharing ideas. And you'll find that leaders and peers in a team with high psychological safety also have the courage to listen to perspectives that differ from their own."

# 07 TIPS FOR PSYCHOLOGICAL SAFETY

1. Encourage a culture of speaking up and sharing different perspectives
2. Avoid the language of failure – a disproven hypothesis is less emotional than an epic failure
3. Build a learning environment; turn mistakes into learning opportunities and focus on the problem, not the person who made the mistake
4. Appoint organisational 'canaries' whose role is to spot issues and share challenging divergent views
5. Demonstrate that different views will be heard, welcomed, and acted upon
6. Practise and promote humility and coping skills
7. Ask open questions and give open and honest feedback

## ORGANISATIONAL OXYGEN

As the founder of organisational consultancy Brink, Freeman helps global corporates and governments to cultivate the mindsets and the skill sets that they need to be innovative.

Freeman describes psychological safety as being rather like oxygen.

"It can be hard to spot," she says. "But we know when it's not present. Typically, when companies don't operate well or have major compliance issues that we hear about in high-profile press stories, we find out later that psychological safety wasn't present."

Wells Fargo is a good example. The California-based multinational famously set goals that were aggressive and audacious, with incentive schemes to motivate teams to hit these targets.

"We all have targets in our work and sometimes they can be very healthy and helpful," Freeman says. "The challenge with Wells Fargo was that no one could challenge those targets. And it began to force really unethical behaviour in employees who were normally good people. People were opening fake accounts to hit their targets and at one point it was found that 3.5 million false accounts had been opened. This time

**+ It can be hard to spot. But we know when it's not present. Typically, when companies don't operate well or have major compliance issues that we hear about in high-profile press stories, we find out later that psychological safety wasn't present.**

**Abigail Freeman**

last year, the bank was a hit with one of the harshest punishments ever handed down by the Federal Reserve. It turned out that some employees had reported the unethical behaviour to their managers and even some to the CEO – but they were fired for speaking up."

## GOOGLE GROUNDWORK

When Google spent two years studying 180 teams in an initiative called Project Aristotle, it found that psychological safety was the strongest predictor of high-performing teams. Ultimately, the company reported that: 'Who is on a team matters less than how the team members interact, structure their work, and view their contributions.'

Brigandi says: "Even if you have all the best talent on one team, if they can't come together to communicate, work and share ideas, they're more likely to be outperformed by a team of lower performers who have learned to collaborate effectively. Ultimately, firms which underestimate the importance of team dynamics are at a huge disadvantage to their competitors."

Inviting multiple perspectives and being open and honest is key to promoting psychological safety.

"Try to ask more open questions – and ask people outside your normal circle for their perspective. More diverse ideas are likely to be found at different levels, roles or functions in the organisation," Brigandi says.

"Try to work in a more candid and respectful way," she advises. "That doesn't mean insulting people, but it does mean being able to give open and honest feedback. Being able to speak up if you disagree with an approach or decision can help surface blind spots or expand thinking – and that takes a lot of courage."

## LANGUAGE OF LEARNING

At Brink, one of Freeman's approaches to cultivating more safety involves avoiding the language of failure.

"The word failure is quite emotive, highly emotional and has pretty negative connotations," she says. "Instead, we use the language of learning. If you tested a hypothesis and it didn't work, then that's not a severe failure. That's a disproven hypothesis. So, we try to keep it much more focused on the science and learning instead of using highly personal and emotional words like failure."

Framing work as a learning journey rather than an execution problem is vital, Brigandi adds.

"Make it part of the process to learn from work and not be solely focused on execution," she suggests. "Of course, you want to deliver the end product. But there is tremendous value in reflecting on the factors of success, failure and how to improve. Particularly in times of failure, it's critical to get curious about what happened and what needs to change to increase team resilience. Leaders have a role to play in encouraging learning at the outset."

An update to the UK's Corporate Governance Code earlier this year highlights the importance of a healthy culture in delivering long-term, sustainable performance and trust in business.

Freeman explains: "Boards are now expected to lead by example and promote the desired culture. Even the Chair has a role to promote a culture of openness and debate. So, these more intangible things are beginning to be hard-baked into how we tackle governance in organisations."

The FCA views culture as a widely accepted root cause of some of the major complex failings in financial services over the past couple years, Brigandi adds. Equally committed to understand culture, the Banking Standards Board recently released its third annual Assessment, "designed to inform, support and challenge banks and building societies that are committed to managing their cultures and raising standards of behaviour and competence across the sector".

While psychological safety is relevant to all industries and organisations, firms that are committed to adopting healthy team practices stand a better chance to weather current disruptions in the banking sector. ✱

■ *This article previously appeared in the Chartered Banker magazine, UK, summer 2019 edition.*

BY ANGELA YAP

# Tax That Bot!

## Can a **'robot tax'** level the playing field for humans?

British-based research firm IHS Markit announced in its April 2019 report, *Artificial Intelligence (AI) in Banking,* that robots and AI could be the cause for the disappearance of over 1.3 million jobs in the US and 500,000 jobs in the UK by 2030. If extrapolated globally, the figure reaches tens of millions of job losses or reassignments throughout the industry.

The report also projects global business value of the deployment of AI in financial services to hit US$300 billion by 2030, a staggering 630% leap from US$41.1 billion clocked in 2018.

Leading the pack is North America (2018: US$14.7 billion vs. 2030: US$79 billion) and the Asia Pacific (US$11.5 billion vs. US$98.6 billion) with China, Japan, South Korea, Hong Kong, and Singapore driving demand for AI within the banking sector over the next 10 years.

Don Tait, Principal Analyst at IHS Markit, points out the most vulnerable segments in the banking value chain: "Banking employees potentially impacted by the introduction of AI include tellers, customer service reps, loan interviewers and clerks, financial managers, compliance officers, and loan officers."

From automated collections processes to anti-money laundering detection and compliance, in an era of thinning margins, greater competition, and the advent of financial technology (fintech) firms, it's hard to dispute the logic or business case for automation in the sector.

It isn't just finance that's getting hot under the collar. Virtually every industry touched by AI or automation will see job cuts and the risk of human obsolescence in the workforce.

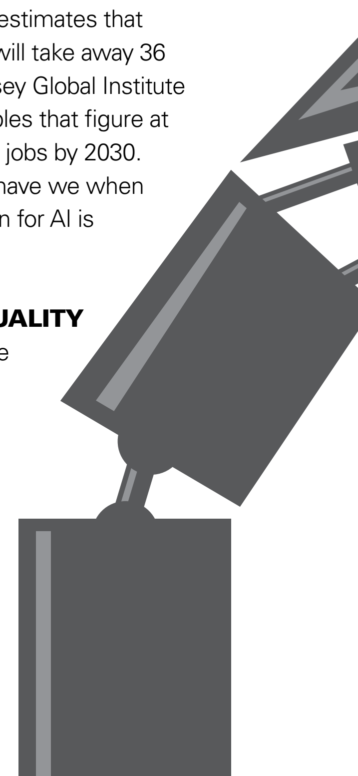
From manufacturing to the services industry, in the US alone, Brookings Institute estimates that AI and automation will take away 36 million jobs. McKinsey Global Institute pessimistically doubles that figure at 73 million American jobs by 2030.

What alternative have we when the value proposition for AI is clear?

**+ It isn't just finance that's getting hot under the collar. Virtually every industry touched by AI or automation will see job cuts and the risk of human obsolescence in the workforce.**

### INCOME (IN)EQUALITY

Andy Haldane, the Bank of England's Executive Director of Financial Stability and once listed by *Time* magazine as among the world's 100 most influential people, has called



the rise of automation "a regressive income tax on the unskilled".

The late Nobel-prize-winning scientist Stephen Hawking, in a public 2015 online Reddit thread, accused machine owners of initiating a "lobby against wealth redistribution".

Technopreneur Elon Musk and other Silicon Valley stalwarts such as Y Combinator's Sam Altman have come out strong and piloted variations of universal basic income in their respective outfits to offset the loss of jobs brought about by robots.

But the most prolific to join this compact of concerned techies is, ironically, one of AI's leading players and one of the world's richest men, Bill Gates.

In a 2017 interview with online magazine *Quartz,* Gates rationalised that machine learning and humans are not at opposite ends of the spectrum. One can't thrive without the other, and there are harmful consequences if policy does not step in to address this phenomenon known formally as 'income polarisation'.

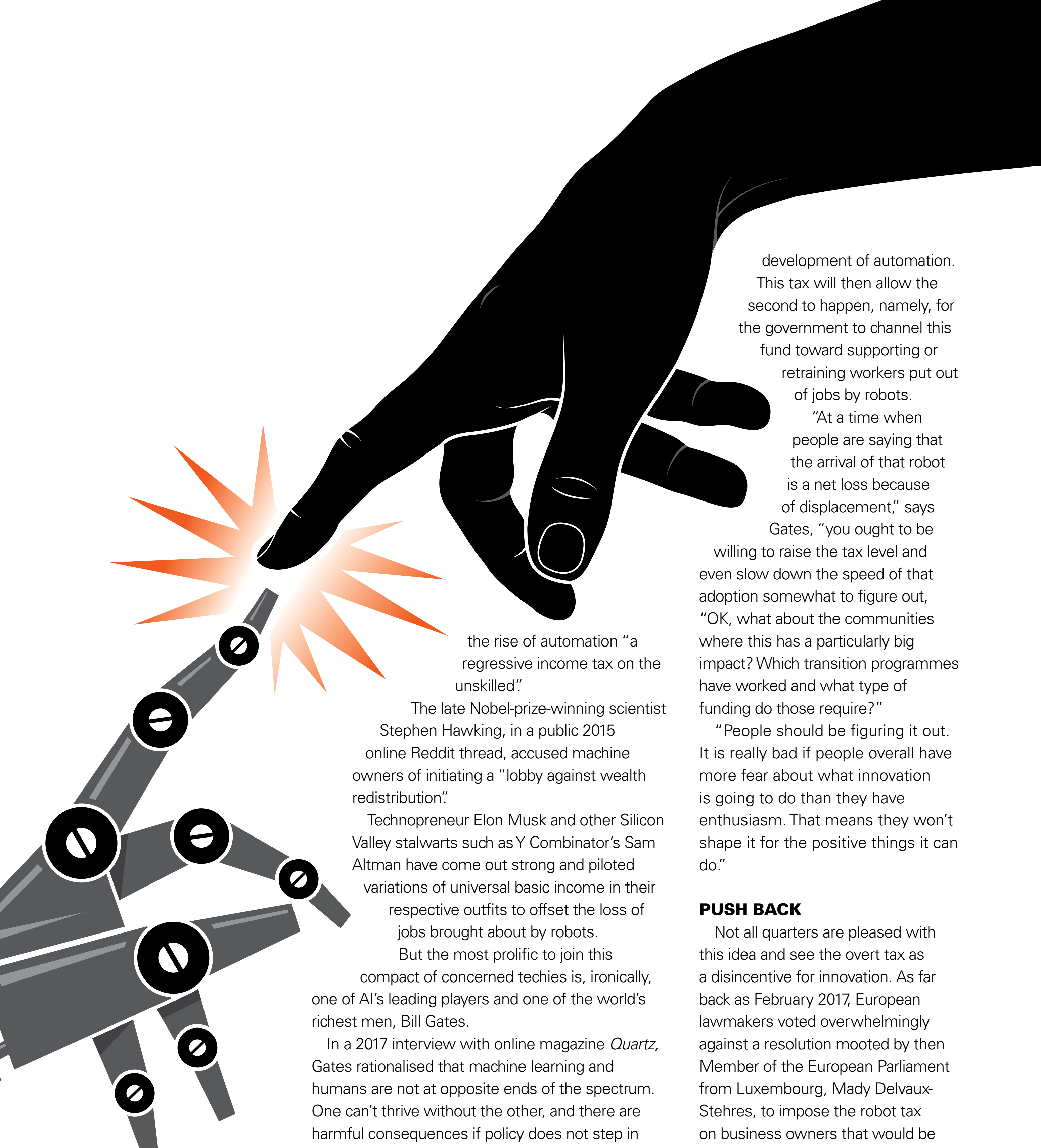
The policy that he's championing is a 'robot tax', an idea that's been bandied around for some time by politicians and is recently gaining ground.

Gates supports the tax for two reasons.

Firstly, a government tax will slow the development of automation. This tax will then allow the second to happen, namely, for the government to channel this fund toward supporting or retraining workers put out of jobs by robots.

"At a time when people are saying that the arrival of that robot is a net loss because of displacement," says Gates, "you ought to be willing to raise the tax level and even slow down the speed of that adoption somewhat to figure out, "OK, what about the communities where this has a particularly big impact? Which transition programmes have worked and what type of funding do those require?"

"People should be figuring it out. It is really bad if people overall have more fear about what innovation is going to do than they have enthusiasm. That means they won't shape it for the positive things it can do."



## PUSH BACK

Not all quarters are pleased with this idea and see the overt tax as a disincentive for innovation. As far back as February 2017, European lawmakers voted overwhelmingly against a resolution mooted by then Member of the European Parliament from Luxembourg, Mady Delvaux-Stehres, to impose the robot tax on business owners that would be redistributed to workers.

One of the bill's most resounding critics, the International Federation of Robotics, issued a statement saying it believes "the idea to introduce a robot tax would have had a very negative impact on competitiveness and employment."

Recently, the tax has resurfaced in political circles. On 5 September 2019, in an op-ed penned for *Wired* magazine, New York mayor and 2020 Democratic US presidential candidate Bill de Blasio made headlines with his proposed policy to implement a robot tax to save American jobs and, ultimately, the future of workers.

"If a company is gonna put thousands of people out of work, they should bear responsibility for making sure that those folks get a new job," said the presidential hopeful on the campaign trail.

The mechanics of this robot tax?

de Blasio describes his version of the tax: "My proposal would institute a robot tax on large companies that eliminate jobs through increased automation and fail to provide adequate replacement jobs. They'd be required to pay five years of payroll taxes up front for each employee eliminated. That revenue would go right into a new generation of labour-intensive, high-employment infrastructure projects and new jobs in areas such as health care and green energy that would provide new employment. Displaced workers would be guaranteed new jobs created in these fields at comparable salaries."

## MODERN-DAY LUDDITES?

At the international level, it's also the subject of serious inquiry. One of its foremost experts is Arnaud Costinot, Professor of Economics at Massachusetts Institute of Technology (MIT), whose recent research paper titled *Robots, Trade, and Luddism: A Sufficient Statistic Approach to Optimal Technology Regulation,* explores how legislation supporting a robot tax could balance the current inequalities faced by to-be displaced employees.

His recent interview with the International Monetary Fund, which is streamed on the organisation's online podcast, outlines how a robot tax must be done right, i.e. crafted in a way that incentivises, not stifles, innovation.

"So one thing that you may wonder is, if better robots create inequality, then maybe we should have less subsidies that go into AI research if that research down the road ends up producing those better robots and aggravating inequality," states Prof Costinot.

The optimal solution, he says, seems to follow a simple rule of thumb – don't tax the creator.

"One of the interesting insights of our analysis [at MIT] is that we should be taxing the robot, not the innovators," he shares.

He elaborates: "What we show is that if the tax on robots is available, then the tax on innovation is no longer needed – so that would be zero."

"If you can impose the optimal tax on robots, then the rate of innovation is going to be the optimal one conditional on that action on robots, as we do not want to restrict innovation."

This approach mitigates the risks of disruption arising from AI and robots.

"Innovation would be unaffected," says Costinot, "because their adverse consequences on inequality would be taxed."

## RACE WITH MACHINES

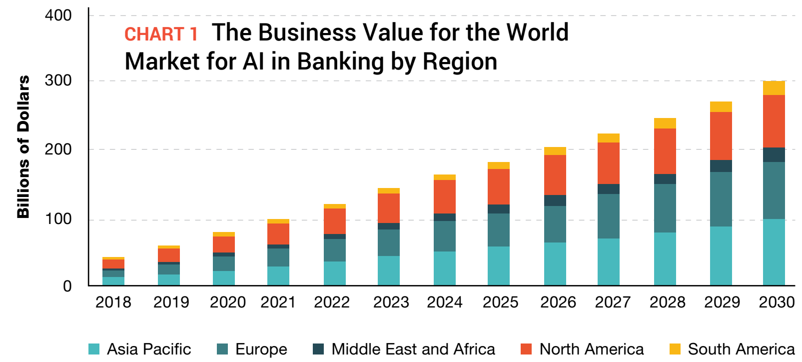
The real fear isn't that all humans will be redundant; rather, that automation will widen the chasm of inequality already prevalent in society amongst humans.

Whilst owners and high-skilled employees are safe for the time being, those involved in low-skilled jobs (repetitive, manual work such as banking tellers, customer service, documentation processing) will be replaced eventually.

When that day comes, what can

**+ So one thing that you may wonder is, if better robots create inequality, then maybe we should have less subsidies that go into AI research if that research down the road ends up producing those better robots and aggravating inequality.**

**Arnaud Costinot,**
*Professor of Economics at Michigan Institute of Technology (MIT)*




**SOURCE** IHS Markit

employers do with staff who lack the ability or aptitude to reinvent themselves and enter higher-value work in banking? For instance, not everyone can be retrained to restructure loans or assess credit. Also, how would we define a 'robot' – are ATMs that replace bank tellers and front office jobs part of the equation?

Automation and human employment are not mutually exclusive, and this is not a zero-sum game. It is merely, as economist Erik Brynjolfsson puts it, the growing pains of a radically reorganised economy.

Remember how 22 years ago, Deep Blue – the IBM-built supercomputer – eventually beat chess legend Garry Kasparov in that historic six-match tournament? Kasparov won the first match, lost the second, drew the next three, and the rest is history.

Drawing from that historic learning, if an outright win isn't possible for humans, then in order to come out ahead, we must adapt and think of computers as our teammates, not competitors.

Low-skilled workers must 'race with the machines' – not against it. This term, penned by Brynjolfsson, describes how employees must add value in a complementary way to new technology.

## MORE HUMANE THAN HUMANS?

"All in all," writes Tait, "AI technology will reconfigure the financial industry's structure, making the banking sector more humane and intelligent."

This closing remark will go down in history as either a winning prediction or yet another monumental gaffe.

Not that the financial sector hasn't seen its fair share of burst bubbles and gung-ho analyses like Tait's.

This fact remains unchanged: IBM's AI machine Deep Blue didn't beat Kasparov because it was more human or humane; it beat the chess legend because of its unbending commitment to calculating the odds and applying the rules on a grand scale. That is cold, hard logic – the antithesis of what we consider the essence of humanity.

It's also debatable if these financier-types genuinely understand the underlying technology in AI and how long the road is before it can fully replace humans. Technology is still some distance away from feeling human emotions or originating creative thought.

AI has been in existence for close to a century. John McCarthy coined the term formally in 1956 but was floating around scientific circles decades before. If human obsolescence were imminent simply because AI was in the periphery, we'd have crashed and burned already.

Yet, here we are.

This is not a Machine vs. Human face-off as fearmongers would have you believe.

Like all other questions of equity and equality, the solution is one that we already know.

Whether we end up a confederacy of humans or machines (or a mix of both), our collective welfare can only be guaranteed when we learn to coexist. ✱

BY ROBERT SOUSTER

# SCEPTICISM

## AN ESSENTIAL QUALITY FOR BANKING PROFESSIONALS

A **'trust no one'** approach can be a good thing.

Codes of conduct issued by professional bodies and corporate codes issued by organisations are characterised by a focus on the duties of a professional banker. These duties are often described using words and phrases such as integrity, honesty, probity, trust, respect and transparency. This is right and proper, as bankers must pay due regard to these duties, and if they fail to do so they will fall short of the expectations of their stakeholders.

Codes of conduct rarely mention scepticism, which despite its absence is an essential quality in the work of many banking practitioners. This article explains the concept, and by using some case scenarios underlines why it is so important.

### WHAT IS SCEPTICISM?

At face value, scepticism appears to be a negative quality. Scepticism implies adopting a questioning mind, or a disbelieving attitude.

By being sceptical, one is unprepared to take information at face value. To be regarded as ethical, we are encouraged to trust and respect others, so if we are not prepared to trust their words or information provided by them, does this not suggest that we are untrusting of others, or worse still, not showing them the appropriate respect?

## SCEPTICISM AS PART OF THE JOB

Some jobs in banking rely on a sceptical approach if they are to be done properly. Internal auditors, or any auditors for that matter, are expected to carry out structured tests to validate information that they process as part of their routine work. It is no surprise that several accountancy bodies have recognised this and incorporated it into their professional codes. This year, the Institute of Chartered Accountants in England and Wales has produced a 16-minute video on professional scepticism, explaining its importance and relevance to contemporary accountants.

In a banking environment, scepticism is not just relevant to those working in accounting roles. The mainstream business of retail bankers is to gather funding resources and lend to individuals and businesses. Neither can be performed effectively without at least some degree of appropriate scepticism. A clear example in respect of funding is where a bank is prepared to accept huge volumes of funds from a source without carrying out appropriate customer due diligence, which would at once place the bank at odds with the anti-money laundering and terrorist financing laws.

## CASE STUDY 1: THE IT ENTREPRENEUR

Jeff is a brilliant IT expert, with a growing reputation for his consulting

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skills. Jeff worked for a large multinational computer company for 10 years and then decided to go out on his own three years ago. He started a private limited company for this purpose, worked from home and was supported by his wife, who dealt with the administration of the business. He turned a small profit in the first year, and then in the second year secured three very lucrative contracts with established companies. These contracts run for another 18 months. Jeff is confident that these three corporate clients will keep him busy, but intends to expand his customer base still further.

He asks the bank to lend him RM50,000 for marketing purposes, supporting his application with two years of accounts prepared by a qualified accountant, as well as detailed business projections.

To his disappointment, Jeff's application for the loan was declined.

## CASE STUDY 2: THE INVENTOR

Tony is well-known to his bank as he runs a company which supplies much of the office stationery used by the bank. The company has been established for over 50 years, having been founded by Tony's father.

Tony approaches the bank for finance and attends an interview. He informs the bank officials that he

In the aftermath of the global financial crisis, many banks were criticised for turning their backs on small- and medium-sized enterprises as their risk appetite diminished. Small businesses whose loan applications had been routinely sanctioned in the past were now being declined. Those that were sanctioned were often subject to availability of collateral.

wishes to borrow money to develop his new invention. Tony shows them an example of his invention, placing it on the table before them. It looks like a large set of plastic tweezers. Puzzled, the bank officials ask Tony, "What is it?", to which he replies "It's a tea bag squeezer". Tony's concept is to develop this invention and offer it to the big tea-producing companies, who could use it for merchandising, with their company logo printed on it.

Tony's application for the loan was declined.

### THERE IS NO SUCH THING AS A GOOD LOAN, ONLY A GOOD RISK

In the aftermath of the global financial crisis, many banks were criticised for turning their backs on small- and medium-sized enterprises as their risk appetite diminished. Small businesses whose loan applications had been routinely sanctioned in the past were now being declined. Those that were sanctioned were often subject to availability of collateral.

Small businesses are especially vulnerable to the swings of the business cycle, and a high proportion of them fail; even if they do not become insolvent, some entrepreneurs return to safer, paid regular employment. In Jeff's case, he would feel let down by the bank, as in his mind he has done nothing wrong. His business is growing and profits are increasing. However, the bank has to look at the bigger picture. Jeff is currently reliant on three substantial clients who will provide him with valuable income for the next 18 months. He hopes to develop more clients and has set down his aspirations in the business plan and projections.

All of what Jeff is doing is worthwhile. He is adding value to society, doing the best for himself and his family. But success is not guaranteed. An experienced, sceptical banker will know that concentration of business risk (i.e. dependence on a few clients) is a major contributory factor in the failure of businesses. Furthermore, if Jeff's plans do not come to fruition, he would not thank the bank if they had advanced a loan that he could not afford to repay. Jeff would probably have gotten the loan much easier before 2007, and that might just have been one explanation to some of the problems that beset the banking industry in those heady days.

Tony's case is more straightforward and demonstrates scepticism of the imagination. His invention was so ludicrously strange that the lenders could probably never envisage it taking off. It is quite possible that Tony would have been turned away by any rationally thinking banker. Bankers have to be sceptical as they cannot be experts in everything, least of all tea bag squeezers.

### POSTSCRIPT

Both of the case scenarios are true stories, though the identities have been changed and the figures omitted.

Jeff's real business grew by 1,000% in his second year (from a low base), but business from all three major customers ran dry in the third year, resulting in a reduction of 42% in turnover and a greater reduction in profit. In that difficult third year, Jeff was forced to borrow from multiple sources, including his parents, to stay in business. His business survived.

Tony developed his invention, funded by mortgaging his existing business premises, and sold the tea bag squeezer to three large multinational tea producers, including the UK market leader.

It does not mean that the bank was wrong to decline his loan application. It simply confirms what a strange, unpredictable world we operate in. ✱

■ *Robert (Bob) Souster is a Partner in Spruce Lodge Training, a consultancy firm based in Northampton, England. He lectures on economics, corporate and business law, management, corporate governance and ethics. He is the Module Director for 'Professionalism, Regulation and Ethics', a core module of the Chartered Banker MBA programme at Bangor University, Wales.*


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WHY YOUR COMPANY NEEDS MORE

# Diversity in Cybersecurity

As cyberthreats become smarter, bringing in fresh perspectives **can make all the difference.**

With millions of unfilled positions around the world, the cybersecurity industry is in dire need of talent. Yet, the field remains overwhelmingly homogeneous, with only 11% of roles being filled by women, according to a study, *The 2017 Global Information Security Workforce Study: Women in Cybersecurity,* by the International Information System Security Certification Consortium (ISC)$^2$. In the Asia-Pacific region, the numbers are worse with women in only 10% of cyber roles and 0% of leadership positions.

Beyond gender inequality, another (ISC)$^2$ study, *Innovation Through Inclusion: The Multicultural Cybersecurity Workforce,* that surveyed the US cybersecurity workforce found a serious imbalance in ethnic groups, with 74% Caucasian employees, 9% black, and 8% Asian. The report also revealed a discrepancy in earnings, with minority groups being paid significantly less than their male Caucasian counterparts.

These numbers need to change; not just because we can't find enough talent where we are currently looking or because 'diversity and inclusion' are current corporate buzzwords.

## THE 'ENEMY' IS ALREADY DIVERSE

Cybersecurity thought leaders have noted that today's cybercriminals are so collaborative that their work almost seems crowdsourced. No matter their group, affiliation, language, or skill set, many cybercriminals share a common goal and willingness to collaborate towards that end.

Any and all weaknesses can and will be exploited by cybercriminals, whose business is built on understanding their adversaries' unconscious bias. When solutions are built by only one group, they become much easier to circumvent. We need to make our strategies less predictable. Diversity in cybersecurity is, therefore, a business imperative, not a 'nice to have'.

## THE MANY DIMENSIONS OF CYBER

Today's cyberthreats are not only technological; they are psychological, political, and even socioeconomic. Protecting against them requires a wide array of skills and a multifaceted approach that can only come from maintaining a diversity of

perspectives, talents, skills, and life experiences from across different cultures to help build more creative problem-solving approaches.

Such diversity can enhance operational effectiveness by helping firms develop new capabilities and innovations more quickly. The communication capabilities required by diverse teams tend to make them more emotionally intelligent, which can also lead to better communication with the rest of the organisation, helping to communicate the urgency of new guidelines and requirements whose adoption could be critical to security.

Looking for more diverse job applicants will help beat the cyber talent crunch. Cybersecurity Ventures' *Cybersecurity Jobs Report 2018–2021* estimates there will be 3.5 million unfilled cybersecurity jobs by 2021. According to the Enterprise Strategy Group's 2018–2019 survey, a lack of skilled talent within the industry was a top concern for IT professionals. If we cast our eyes further afield than conventional curriculum vitae's and recruiting fairs, and think about the different kinds of talent that could be applied to cyber, we will be able to fill at least some of the millions of vacancies. And diversity is a virtuous cycle; when individuals see themselves represented at the table, they will be all the more encouraged to take a seat.

## MAKING DIVERSITY IN CYBERSECURITY A REALITY

Ultimately, as threats become smarter, bringing in fresh and new perspectives can make all the difference in staying ahead of bad actors. The Financial Services Information Sharing and Analysis Center (FS-ISAC) continues to stay ahead of the curve by attracting a wide range of diverse talents to join us.

To help confront the talent crunch at an industry level, FS-ISAC launched the Building Cybersecurity Diversity Scholarship in 2016 to help introduce women interested in careers in cybersecurity to the financial community.

The financial industry is on the front line of addressing new and emerging cybersecurity threats that have a global impact and has a prominent role to play in helping build a workforce to address these new challenges. Supporting the education of under-represented specialists will help ensure financial institutions continue to maintain strong internal teams.

We can also diversify cybersecurity teams by 'extending' them through intelligence sharing.

Information sharing and analysis centres (ISACs) have been around for 20 years and are, now more than ever, a crucial piece in the fight against cybercrime.

ISACs allow firms, communities, and even entire sectors to share intelligence generated by one firm or even one team around the world in a trusted, peer-to-peer network. Active collaboration between organisations help provide insights from a myriad of sources, leading to diversity via exposure.

When it comes to cyber intelligence, the more varied the data and approaches, the better the decisions, and the more able cyber professionals will be to protect the customers and citizens they serve. ✱

■ *Brian Hansen is the Executive Director of FS-ISAC Asia-Pacific. Prior to his time at FS-ISAC, Brian worked for the Pharmaceutical Security Institute as the Senior Intelligence Analyst directly coordinating the production of intelligence analysis for executive leadership on criminal involvement with global counterfeit pharmaceutical networks, including cyber-based networks. Earlier, he served in the US Department of Defense for 26 years in intelligence and foreign affairs roles with increasing responsibilities, culminating as the principal intelligence officer for the Deputy Assistant Secretary of Defense, East Asia, with responsibility for Taiwan, China, North and South Korea, Japan, and Mongolia. Brian received his Master of Arts degree in Global Affairs from George Mason University focusing on global conflict and security. He is fluent in Mandarin, Portuguese, and Spanish.*

# Cryptocurrency Kryptonite?

Far from becoming a ubiquitous payment method, **digital currencies seem to be sliding down** a slippery slope.

**+ Given the volatility and uncertainty governing crypto exchanges like Coinbase, it adds up why legit investors still view cryptocurrencies like Bitcoin and Monero as high-risk investments rather than reliable payment methods.**

In April 2018, a *Thomson Reuters* survey found that one in five financial firms – from hedge funds to the biggest banks – were considering trading in digital currency within the next three to 12 months.

Joining the chorus was Brian Kelly, CEO of digital currency investment firm BKCM and CNBC talking head, who was quoted as saying: "In the last month we have seen Goldman and Barclays publicly acknowledge they are planning to trade cryptocurrency. That has everyone on notice that institutional money is ready to enter the market."

Fast forward to 2019.

On 21 June, the intergovernmental Financial Action Task Force (FATF), issued a much-debated standard encompassing its 37 member nations, requiring cryptocurrency exchanges to pass on information about customers when transferring funds. *FATF Interpretive Note to Recommendation* 16 requires originator and beneficiary data to

In the ensuing months, financial institutions (FIs) grappled with the imposition of bank-like measures on virtual asset trading and their issuers. Ultimately, they chose to err on the safe side of AML/CTF concerns and toughened their stance on crypto trading and exchanges.

accompany each transaction with names; corresponding account numbers; and physical address or identity, or date and place of birth.

The directive, which on the surface seems counterintuitive to Open Banking's promise of upholding data privacy, was necessary to "adequately mitigate the money laundering and terrorist financing risks associated with virtual asset activities".

Although non-binding, member nations who do not comply with FATF's recommendation for anti-money-laundering policies risk getting blacklisted as banks are now held legally liable under the new FATF regulation.

## STACKED ODDS

In the ensuing months, financial institutions (FIs) grappled with the imposition of bank-like measures on virtual asset trading and their issuers. Ultimately, they chose to err on the safe side of AML/CTF concerns and toughened their stance on crypto trading and exchanges.

By July, industry body CryptoUK surveyed that 75% of all cryptocurrency businesses in Britain banked overseas due to the difficulty of getting banking services onshore.

Simultaneously, unofficial reports trickled in that all four South Korean cryptocurrency exchanges were facing issues on the renewal of their agreements with banks. Previously, these accounts were renewed half-yearly with no objection. South Korea's Financial Intelligence Unit recently proposed that the country moves from "indirect regulation through commercial banks to direct regulation" under the government via a licensing system.

Then in August, rumours were abuzz that Barclays Bank had ceased to provide banking services to a major US-based cryptocurrency exchange, Coinbase. The deal had previously allowed Coinbase users to easily tap into the banks Faster Payments Scheme, allowing users to deposit and withdraw sterling through the British bank directly, which cleared a massive hurdle plaguing most digital currencies, i.e. convertibility from digital to fiat.

Although Coinbase quickly found a new banking partner, a challenger called ClearBank, it now reportedly "takes days to process" UK deposits and withdrawals, which has impacted Coinbase uptake.

Given the volatility and uncertainty governing crypto exchanges like Coinbase, it adds up why legit investors still view cryptocurrencies like Bitcoin and Monero as high-risk investments rather than reliable payment methods.

## ALTCOINS

It has also led to a slew of new coins (also known as alternative coins or 'altcoins') seeking to cash in on the hype of cryptocurrencies with slightly differentiated value propositions from the first-generation crypto.

Called 'stablecoins', there are essentially three types of alternative coins differentiated by design to address various shortcomings of its predecessors:

- ***Fiat-backed:*** Pegged against a unit of account such as the US dollar or Euro, issuance is by a centralised entity for IOUs redeemable at a 1:1 ratio against an underlying asset with active measures to maintain the peg. It addresses the issue of volatility and has the potential for widespread adoption in future. However, as it is backed against fiat, its trustworthiness remains only as long as there is trust in the centralised entity's ability to cover the IOU. This makes it susceptible to significant counterparty risk as seen in the Mt. Gox scandal, when one of the world's largest Bitcoin exchanges in Tokyo filed for bankruptcy in February 2014 after announcing that approximately 850,000 Bitcoins totaling US$450 million were missing and likely stolen.
- ***Crypto-collateralised***: Is also known as 'on-chain issuance' in reference to the collateral that is held in a smart contract on the blockchain. Issuance is decentralised via a 1:1 peg against crypto assets. In this manner, crypto assets become

debt collateral and its use smoothens price volatility in the market. The smart contract allows for transparency and audit trails of reserves. When the stablecoin debt is settled, the collateral will be 'redeemed'. However, it risks under-collateralisation if the value of the collateral drops below a predetermined value. The system will liquidate the stablecoin. For this reason, this type of stablecoin must be over-collateralised at the point of issuance.

- ***Algorithmic or non-collateralised:*** There is no collateral backing the supply of coins. Instead, it is mathematically determined to either expand or reduce coin supply in circulation. The method is similar to how fiat currencies maintain stability and supply. The underpinning idea is one of economics – to control monetary supply through a smart contract that will only issue coins that will trade at US$1.

For instance, if the price of this stablecoin drops below US$1, the system will begin issuing 'shares' for investors to buy its stablecoin in the open market at less than US$1. When prices exceed the US$1 mark, 'bonds' will be issued to remove coins from circulation. Due to this unique mechanism, algorithmic stablecoins are also known as 'seigniorage shares', i.e. the profit made by a government through issuing currency.

Another stablecoin variant is JPM Coin, launched by JP Morgan using its distributed ledger platform named Quorum. It is fully redeemable for fiat and only available to its institutional customers that clear the bank's Know Your Client check.

This means that the network is 'entirely permissioned' i.e. centralised and controlled by JP Morgan itself, with the added assurance to its clients that it is stable as the bank's strong balance sheet backs it. However, the coin it is only available to the bank's institutional and private investors.

## IN ON THE ACTION

On 3 June this year *Wall Street Journal* reported that a 14-bank coalition led by UBS Group AG was established to settle its cross-border trades on the blockchain using a Bitcoin-like token which they call a Utility Settlement Coin (USC). Currency held at central banks back the proprietary token. The company, Fnality International, saw a collective investment of GBP50 million for the deployment of its blockchain-based trade settlement platform.

The USC token would perform a dual-function as both payment device and carrier of crucial information to complete a trade, allowing for quicker settlement and reduction in the rate of failed trades, especially in cross-border transactions which can take weeks for settlement to occur. It also reduces the probability of failed trades if one party doesn't fulfil its contract terms.

Commenting on upsides of the new initiative, Hyder Jaffrey, head of strategic investment, at UBS said: "You remove settlement risk, the counterparty risk, the market risk. All of those risks add up to costs and inefficiencies in the marketplace."

The newspaper also quoted Rhomaios Ram, Chief Executive at Fnality, that it was "working with regulators in several countries to get the necessary approvals" and expects the USC token to be fully operational within 12 months.

Governments as well have leapt at the possibility of devising their own stablecoins to rival cryptocurrencies, in particular, the Facebook-backed Libra digital currency which many see as a threat to global financial stability.

The sheer size and influence of Facebook's endeavour to create a "global cryptocurrency" makes it the primary focus of antitrust investigations and financial regulators.

EU Competition Commissioner Margrethe Vestager said it sent out early-stage probes into how Libra works. "From both a competition and a financial stability perspective, Libra will have our interest," she recently said to reporters in Copenhagen.

Also in response to Libra, France and Germany are calling for a revival of an EU-based central bank digital currency (CBDC), which it proposes to make publicly available in the 19-country bloc, bypassing intermediaries – banks and clearing counterparties – to deposit electronic cash directly at the European Central Bank.

On this occasion, one should question whether CBDCs are a risk to the global financial system if the proposal becomes a reality.

## 'ALL ELSE IS NOT EQUAL'

The idea of a global digital currency has also gained traction, amongst others, Mark Carney, Governor of the Bank of England, who sees it as a counterweight to the realities of the existing international monetary and financial system that is tipped in favour of the few.

In a speech on 23 August 2019, Carney said: "Unfortunately for emerging market economies, all else is not equal."

"Their efforts have not been sufficient because of the consequences of the growing asymmetry between the importance of the US dollar in the global financial system and the increasingly multi-polar nature of global economic activity."

In this regard, Carney points out that an international stablecoin fully backed by reserve assets in a basket of currencies – including the US dollar, the euro, and sterling – could support better global outcomes and counter "the domineering influence of the US dollar on global trade".

His comments, pointedly made during a symposium sponsored by the US Federal Reserve in Wyoming, highlight the potential of digital currencies – also referred to as synthetic hegemonic currencies (SHCs) – to establish a new equilibrium away from the US dollar. Hypothetically, it could help stabilise financial systems distorted by trade and currency wars and is preferable to other currencies such as the renminbi becoming the global reserve.

"An SHC could dampen the domineering influence of the US dollar on global trade. If the share of trade invoiced in SHC were to rise, shocks in the US would have less potent spillovers through exchange rates, and trade would become less synchronised across countries.

"By the same token," says Carney, "global trade would become more sensitive to changes in conditions in the countries of the other currencies in the basket backing the SHC. The dollar's influence on global financial conditions could similarly decline if a financial architecture developed around the new SHC and it displaced the dollar's dominance in credit markets.

"By reducing the influence of the US on the global financial cycle, this would help reduce the volatility of capital flows to emerging market economies."

But that is far in the offing. Whether through private sector initiatives such as Libra or CBDCs, gaps remain on how wide-ranging policy issues such as privacy, anti-money laundering and counter-terrorism financing, and operational resilience will be mitigated.

## DANGEROUS DALLIANCE

Already, we see broken economies like Venezuela trying to rig the game with the government's controversial cryptocurrency, petro. Purportedly pegged to the nation's oil and gas, gold, and diamond reserves, the digital currency is widely shamed as a ploy by dictator President Nicolas Maduro to pull the wool over Venezuelans' eyes.

Brookings Institute's *TechTank* blog writes: "…it is relatively unsurprising that a dictatorship with little reserve currency…has resorted to a deceitful means like introducing the petro…to create foreign currency reserves from thin air" and warns that the petro undermines the credibility of all cryptocurrencies.

Additionally, it warns that sanctioned nations "might pursue the same fraudulent strategy as Venezuela: create a cryptocurrency tied to a government-controlled asset, raise money in violation of sanctions, and proceed to manipulate that cryptocurrency's value to maximise profit".

With such blatant manipulation, banks must learn to play the hand they have been dealt.

Joe Leonard, Senior Vice-President for Technology and Chief Information Security Officer for the Federal Reserve Bank of New York, once said in an interview with *Wall Street Journal:* "Something will happen, without question. The question is how big is it going to be, how bad is it going to be, or have we put the right processes in place to sort of contain it and manage it."

Will banking's dalliance with cryptocurrency become its kryptonite? ✱

■ *Kannan Agarwal is a Singapore-based researcher with Akasaa, a boutique content development and publishing firm.*

BY KANNAN AGARWAL

# BRINGING DOWN CHARGE-OFFS

With delinquencies on the rise, here's how banks can tip the scales in their favour.

Charge-off – the declaration that a debt is unlikely to be collected after a customer is delinquent – is a significant risk for banks.

What's more, global growth is softening, and lending is, once again, at pre-crisis levels with an increase in defaulters across consumer segments.

Take, for instance, credit cards. According to data released by the central bank of China in its *2019 Second Quarter Payments System Operations General Circumstances* report, major Chinese banks reported a slowdown in active credit card growth in 2H2019 with a corresponding rise in delinquency rates.

As of 30 June this year, one of China's largest financial institutions, Bank of Communications Ltd, reported a 2.49%

**TABLE 1 KEY COLLECTIONS MIGRATIONS**

| | TRADITIONAL COLLECTIONS | NEW-AGES COLLECTIONS |
|---|---|---|
| **STRATEGY** | **LENDER CENTRIC** | **CUSTOMER CENTRIC** |
| Aiming to... | Minimise dollars at risk | Optimise customer experience |
| Focusing on... | Efficient mass actions | Tailored "Next Best Treatment" |
| Measuring performance by... | Dollars collected per hour | Dollar cure raise and future sales/revenue |
| **ANALYTICS** | **FACT-BASED** | **SENTIMENT-BASED** |
| Collecting data from... | Customer transactions and statement | Customer touchpoints plus traditional sources |
| Capturing... | Credit line utilisation, days past due | Keyword sentiment (i.e., "illness", "bankruptcy" |
| Updating strategy... | Through manual, periodic updates | Automatically with machine learning |
| **OPERATIONS** | **MASS WIDGETS** | **JOURNEY MANAGEMENT** |
| Reaching out via... | Telephone, primarily | Customer's preference of phone, SMS, IM, etc. |
| Checking compliance... | Offline | Real-time via Robotic Process Automation |
| Monitoring... | Roll rate and activity | Daily cash flow and long-term profit |

**SOURCE** Accenture blog, Delinquent Debt Collections in the 'New', 6 September 2018

rise in credit card delinquencies, an increase of 0.97 percentage points. Other large state-owned banks such as Shanghai Pudong Development Bank Co Ltd and Ping An Bank Co Ltd reflect this trend. One of the worst performers, China Merchants Bank Co Ltd, saw credit card delinquencies leap by a staggering 33%.

It is the same in the auto loans segment in North America. In August 2019, the Federal Reserve Bank of New York reported that 2Q2019 serious auto loan delinquencies (defined as >90 days past due) rose 4.6% equivalent to a 47-basis-point increase year-on-year.

Closer to home, *South China Morning Post* on 7 October 2019 wrote that data from Singapore's Credit Bureau clocked an over 50% increase in mortgage defaults since 2017. This rise follows the governments' downward revision of GDP growth forecast to 0%–1% for the year, made just two months prior. The newspaper quoted Maybank economist Chua Hak Bin who opined that "bankruptcies are also rising, in line with the mortgagee sales, as the economy grinds to a standstill".

These red flags are like canaries in the coal mine, a clear signal that banks must act now to beef up credit collections and build credit resilience in anticipation of a downturn.

Here's how banks can transform their collections strategy in the digital age.

## NEW BEHAVIOURS & EXPECTATIONS

Customers increasingly prefer texts over voice calls, email correspondence over letters. Many millennials – a growing customer base for financial institutions – don't own a personal landline number, have not activated voicemail, and don't answer calls from private numbers or unknown caller IDs.

Financial institutions must wrap their heads around the new psychology and habits of today's consumer, a defining feature of an effective collections strategy, according to Dan Kreis, Accenture's North America Payments Senior Principal.

In his blog post, Kreis elaborates how traditional methods no longer apply, and banks must embrace different psychology in this era of 'new-aged collections'.

This mind shift from old to new is summarised (see **Table 1**).

It is important to note that the end goal has not changed – an effective collections strategy will bring about higher efficiency and increase in the 'cure rate' i.e. collection of non-performing loans. What has changed is the journey, and what it takes to reach the promised land.

Traditionally, a collections strategy focused on lender-centric operations and prioritised risk mitigation and cost minimisation. Mass mailouts, generic processes that lumped late payments according to ageing buckets (30 days due, 60 days due, >90 days due) are well established and typical in collections units.

But in today's environment, if banks want to up the cure rate, they must instead focus on providing customer-centric solutions which place end-users at the heart of decision-making.

The following two elements – officer training and behavioural analytics – are crucial. Applied correctly, they could even save banks from potential PR backlash or even lawsuits given stricter laws for privacy and against consumer harassment.

- **Officer (re)training.** Collections officers must be equipped with new skills on several fronts. New agents should be paired with low-risk groups and follow scripts in the initial stages, whilst only highly experienced and skilled officers should be assigned to high-risk customers as they will be able to navigate the discussion and make a judgment call in difficult situations.
  This continuous training of collections officers – from rookie to seasoned veteran – must include new skills such as the ability to detect verbal cues indicating the appropriate customer profile. For instance, if the customer explains that an illness or hospitalisation caused the overdue, a more negotiable, softer manner can be taken to draw up a plan of repayment or deferment. However, if the customer is abusive in tone and manner, then a more remote approach – issuance of reminder letters and in-app login notifications – should be the strategy taken.
  If at any one point, the word "bankruptcy" is uttered, officers must then adjust the strategy accordingly and channel them to a different path for resolution.

- **Behavioural segmentation.** Instead of grouping delinquents and at-risk segments according to ageing buckets, a better approach that's proving to be effective is to group customers based on behavioural categories. It's important to note that there is no standard metric for this as each bank differs in demographics. However, behavioural profiles to consider include:
  - Reasons for failure to pay (did they lose their job recently or are they habitually late in payments);
  - Low-risk vs. high-risk groups (what age are they, where do they work); and
  - Customers' personal experiences with the bank (how long have they banked with you, what's their repayment record).

  Once this behavioural grouping is established, the next important step is to pair them with the right collections officer or agent. Previously, this was difficult to do but it is easily achieved with the use of data analytics today.
  A proven strategy is to match officers with profiles similar to the customers' gender, age, regional dialect, to put the customer at ease.
  Banks who have employed smarter pairings have reported a reduction in overall losses by as much as 20% and lower relapse rates of cured customers.

## DIGITAL FIRST

McKinsey's survey on *Digital Debt Collections and Credit Loss Resilience,* published in April 2019, provides insight into the landscape of technology adoption amongst customers and banks:

+ Most issuers still pursue traditional contact strategies based on the delinquent customer's balance, risk profile, and days delinquent. The strong preference of lenders is to prioritise outbound phone calls and letters, especially in later delinquency. Digital contact channels include email, text messaging, and online collections.
+ Delinquent customers expressed a preference to be contacted primarily by email and text message. They also report that issuers mainly use traditional

**But in today's environment, if banks want to up the cure rate, they must instead focus on providing customer-centric solutions which place end-users at the heart of decision-making.**

contact channels. Low-risk customers in particular prefer alerts and notifications via voice mail or email, and to take action in their own time. These 'digital first' customers are identifiable by simple characteristics like demographic data, balance, payment behaviour, channel of acquisition, and use of online banking and apps. They represent a significant portion of the total delinquent population and vastly outnumber those who say they prefer traditional channels.

+ In responding to issuers' contact strategies, digital-first and traditional-channel customers behave very differently. The digital-first segment is 12% more likely to make a payment when contacted by the bank through a preferred digital channel in early delinquency. In late delinquency, this likelihood rises to 30%. The proportion of these customers who pay in full also doubles when they are contacted through digital channels. A small minority of customers still prefer phone and letter contact, a distinct population that typically pays in full.

It proves two things: Firstly, there's an apparent mismatch between the lenders' contact strategies and contact preferences of delinquent customers. Second, incorporating digital platforms for communication and collection from the customer is showing results for banks.

The report outlines some options for banks in implementing digital-first strategies:

+ Using push technology to send automated text reminders every three days until the amount past due is settled.
+ Employ an analytics-based digital campaign to separate loans into ageing buckets with differentiated digital contact strategies for each, e.g. customers in pre-delinquency stage can 'self-cure' (pay on their initiative) with no personal contact in order to up the self-cure rate as they are proven to more likely pay on their own initiative; whilst unresponsive customers in advanced stages of ageing (>90 days) can be profiled as fraud and dealt with in more rigorous manner.
+ Deploy an orchestrated omnichannel digital contact strategy. Should customers not respond after a reasonable amount of time, only then will the case be passed on to agents for skip-tracing and personal collections.

As there is no one-size-fits-all solution, it is up to each financial institution to weigh their options and develop a 'path of least resistance' when applying new technologies.

**OPTIMISE CREDIT OPERATIONS**

Post-2007, a host of regulatory requirements and accounting rules have made it easier for credit risk managers to get an enterprise-wide view of risk across liquidity classes, operations, and markets.

Nonetheless, mergers and acquisitions or legacy issues still exist, resulting in multiple credit reporting platforms, inefficient duplication of processes, or conflicting credit rules within an organisation.

These necessitate a redesign of one's entire credit process and systems – from loan origination right through to monitoring and collections. Although this seems an expensive endeavour, banks that embark on such initiatives can expect returns in the medium to long term.

One global consultancy reports a European bank clocked a significant lowering of its cost-of-risk, from 50 basis points above its peers to 23 basis points below within three years – a total reduction of 73 basis points on average.

Although such transformations (or overhauls) may seem innovative today, given the pace of change in finance, this could soon become banking's new normal.

With that in mind, it pays to stay ahead of the curve, especially when it comes to credit risk. ✱

BY DR AMANDA SALTER & ADELENE TEO

# Pause. Think. Apply.

## REDESIGNING CUSTOMER EXPERIENCE IN BANKING

A paradigm **shift on regulatory compliance** and what it takes to gain loyalty.

Customer experience, or CX for short, has become an established buzzword in the services industry.

In recent years, leading banks in Asia Pacific, including DBS, OCBC, and Hong Leong, have come forward to declare their commitment to CX, recognising the potential and capability of customer experience initiatives to drive service differentiation, customer loyalty, and ultimately business performance.

In fact, organisations that have strategically placed CX at the heart of their process (re)design have emerged with the right end of the stick.

This article delineates good CX principles, its risk and rewards, and how it successfully dovetails with current Open Banking regulations to inspire greater customer loyalty.

### BANKING'S NEW LEXICON

For those who are new to the concept of CX, let's start with a quick definition.

What does a 'great customer experience' actually mean in banking?

Broadly, it means bringing a customer-centred mindset to the ecosystem of banking services, making banking easy and enjoyable for customers. It means recognising each customer as an individual, prioritising their needs over just selling them more products.

As Bill Gates famously said, "Banking is necessary, but banks are not". Financial institutions that truly understand this undergo a complete transformation of mindset. This works its way from top-level strategy all the way down to internal processes of each department.

With the rise of 'digital only' banking and proliferation of digital banking products, customer-led thinking has a huge influence in how these products (websites, apps, kiosks, etc.) are designed to be human and user-friendly.

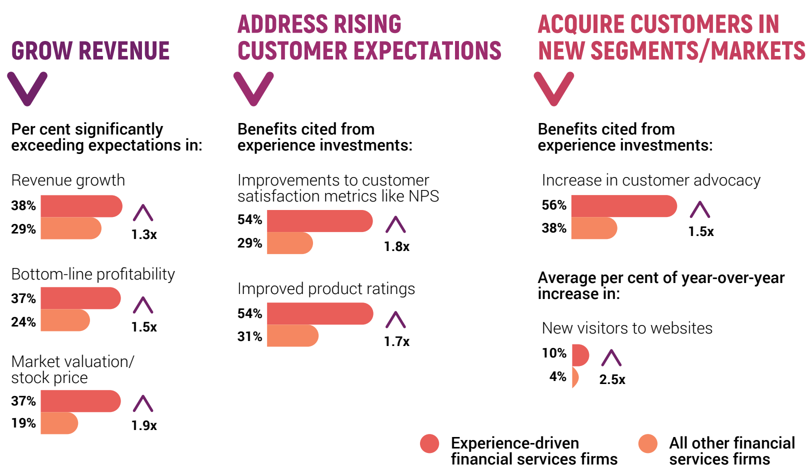
Specifically, there are a number of emerging themes in delivering a

**+ "Banking is necessary, but banks are not". Financial institutions that truly understand this undergo a complete transformation of mindset. This works its way from top-level strategy all the way down to internal processes of each department.**

**FIGURE 1 THE BUSINESS BENEFITS OF IMPROVED CX**


**SOURCE** Dr Amanda Salter

**FIGURE 2 FINANCIAL SERVICES FIRMS THAT ARE EXPERIENCE-DRIVEN AND PRIORITISE CX SEE GREATER IMPROVEMENT ON REVENUE, SATISFACTION, AND GROWTH METRICS COMPARED WITH BUSINESS-AS-USUAL**




**SOURCE** Forrester Consulting

great experience for customers. Customers are looking for these things from their bank:

- **Convenience.** Enabling customers to bank in any way, any place, on any combination of device or channel, and at any time that suits them best.
- **Ease and simplicity.** Customers want to work with banks that are easy and simple to work with, that require minimum effort and time from them. They expect a one-touch resolution for any issues they may face.
- **Consistency of experience.** This includes seamless handoffs between channels. For example, being able to shift from web to phone to branch and back to web, without having to repeat themselves or rekey information.
- **Personal treatment.** Customers expect their bank to know their history as an individual and to recognise their loyalty. This includes awareness of the products and services they have, and to provide relevant and informed prompts, advice, or suggestions.

## THE CARROT

What exactly do banks stand to gain from investing in CX as a science?

A 2019 McKinsey report puts it succinctly: "When it is done right, customer experience in retail banking leads to more satisfied customers, happier team members, increased efficiency, accelerated growth, and reduced operational risk."

We've expanded on this to express the business benefits of improved CX (see **Figure 1**).

Further, in a February 2018 study commissioned by software developer Adobe Inc, Forrester Consulting found that CX-focused financial services firms enjoyed higher revenue and business performance, increased customer satisfaction and loyalty, and higher customer acquisition (see **Figure 2**).

It also solves one of banking's big pain points – customer loyalty…or

Bain & Co's November 2017 feature, *Evolving the Customer Experience in Banking,* cites the rise of Alibaba's online MYbank, which offers instant loan approval based on an applicant's financial history with Alibaba, and Rakuten's burgeoning banking and credit card services, as proof that tech is upending retail banking.

lack thereof.

McKinsey's April 2018 report, *Asia's Digital Banking Race: Giving Customers What They Want,* discovered that loyalty is a significant issue for banks in Developed Asia (Australia, Hong Kong, Japan, New Zealand, Singapore, South Korea, Taiwan), where only around 40% of consumers would recommend their bank to a friend compared to 70% in the Emerging Asia markets.

Another 2018 study by Frost & Sullivan, titled *Retail Banking CX Singapore: Insights on Opportunities and Trends to Create a Competitive Advantage,* even found that 40% of Singapore banking customers stopped or cancelled their services with a bank due to poor CX.

There is also evidence that Asia-Pacific banks are losing ground to giant tech firms – organisations well versed in improving the customer experience – when it comes to customer uptake of banking services.

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Which explains why global banks like Chase, Citi, Bank of America, Royal Bank of Canada, have followed in their footsteps, pouring millions of dollars into remapping the customer journey.

## OPEN BANKING DEMANDS GREATER CX

Banks need to also recognise the CX-led shift taking place in


# KYC Gets Aboard the CX Train

Poor KYC customer experience is costing banks millions. In 2016, *Thomson Reuters* reported that 89% of corporate customers haven't had a good KYC experience, and 13% switched banks as a result.

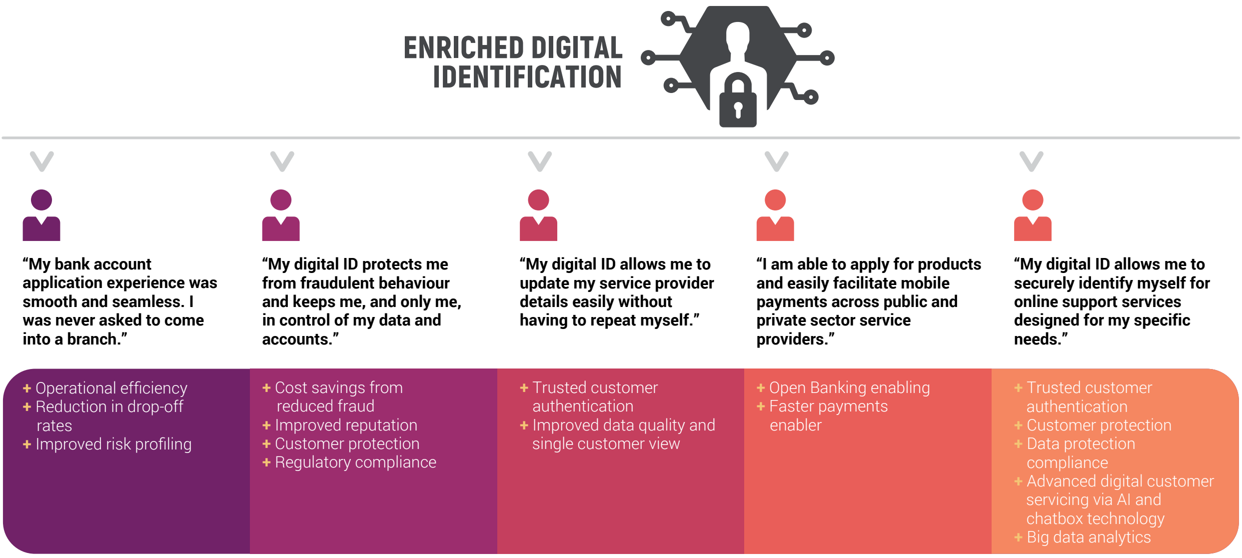
What does a good KYC experience look like for customers?

- **Rapid, simple, one-touch onboarding.** No compromises or get-out clauses.
- **No need to channel shift.** Customers must be able to complete an application within the channel of their choice. No more forcing customers to fill in forms online, do some paper photocopies, reply to emails and phone calls, and then visit the branch.
- **No more being the middleman.** For many customers, it's a hassle to source information from one place to send to another, in the 'correct' format. There's also the risk of needing to resend if paperwork gets lost.
- **No more chasing.** Customers would much rather spend time with their families than keep phoning up to check on progress.
- **No need to search and send documents (again!).** Whether applying for a new product from another division/branch of a bank or becoming a customer at a different bank, an enjoyable onboarding process retains customers or recruits new ones.

Though most incumbents are still finding their footing, several challenger banks have managed to deliver the optimum KYC experience. By placing customer satisfaction at the core of their onboarding process, they've leveraged Open Banking technology and established:

- shorter onboarding time;
- increased data accuracy;
- reduced KYC resources required;
- increased customer acquisition rate; and
- simplified internal processes.

**FIGURE 3 BENEFITS OF CX PRINCIPLES APPLIED IN AN ENRICHED DIGITAL IDENTIFICATION PROCESS**




**SOURCE** Ernst & Young LLP.

regulation.

The push for Open Banking (OB) isn't just about financial transparency and giving customers control over their data.

In fact, OB regulations such as Europe's Second Payment Services Directive and Australia's Consumer Data Right are, in essence, customer-centric regulations devised to leverage new technologies in order to transform financial markets.

Currently, the responsibility for CX is siloed within each business unit. Banks must break down these walls and implement CX as an overarching bank-wide strategy.

Instead of finding the swiftest solution to a new regulation, financial institutions should pause, think, and apply design principles to find the best solution that meets the regulators, banks and customer's needs concomitantly.

Quit approaching regulatory compliance in isolation, stop unloading all the compliance and risk burdens onto customers, and start committing towards enhancing customer experience.

**Quit approaching regulatory compliance in isolation, stop unloading all the compliance and risk burdens onto customers, and start committing towards enhancing customer experience.**

It isn't far-fetched to say that banks which don't put CX at the heart of its operations are bound to fail.

But all is not lost.

One of the best CX implementations in Open Banking, which all banks can draw inspiration from, is the redesign of the Know Your Client (KYC) process (see box story), proof that banks can elevate the customer experience by design and earn their loyalty in return. ✱

■ *Dr Amanda Salter is Principal Partner for CX-led content design at Akasaa. Based in Newbury, England, she holds a PhD in human centred web design and BSc (Hons) in Computing Science.*

*Adelene Teo is currently Economic Adviser to a foreign diplomatic mission. She was previously a manager at Bank Negara Malaysia's Islamic Financial Infrastructure Development section.*

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