Exclusive Interview with Chartered Banker, Datuk Nora A Manaf, Group Chief Human Capital Officer, Malayan Banking Berhad
Banking is about Expanding the Possibilities of Humanity

BANKING INSIGHT

IDEAS FOR LEADERS | **DECEMBER 2020**

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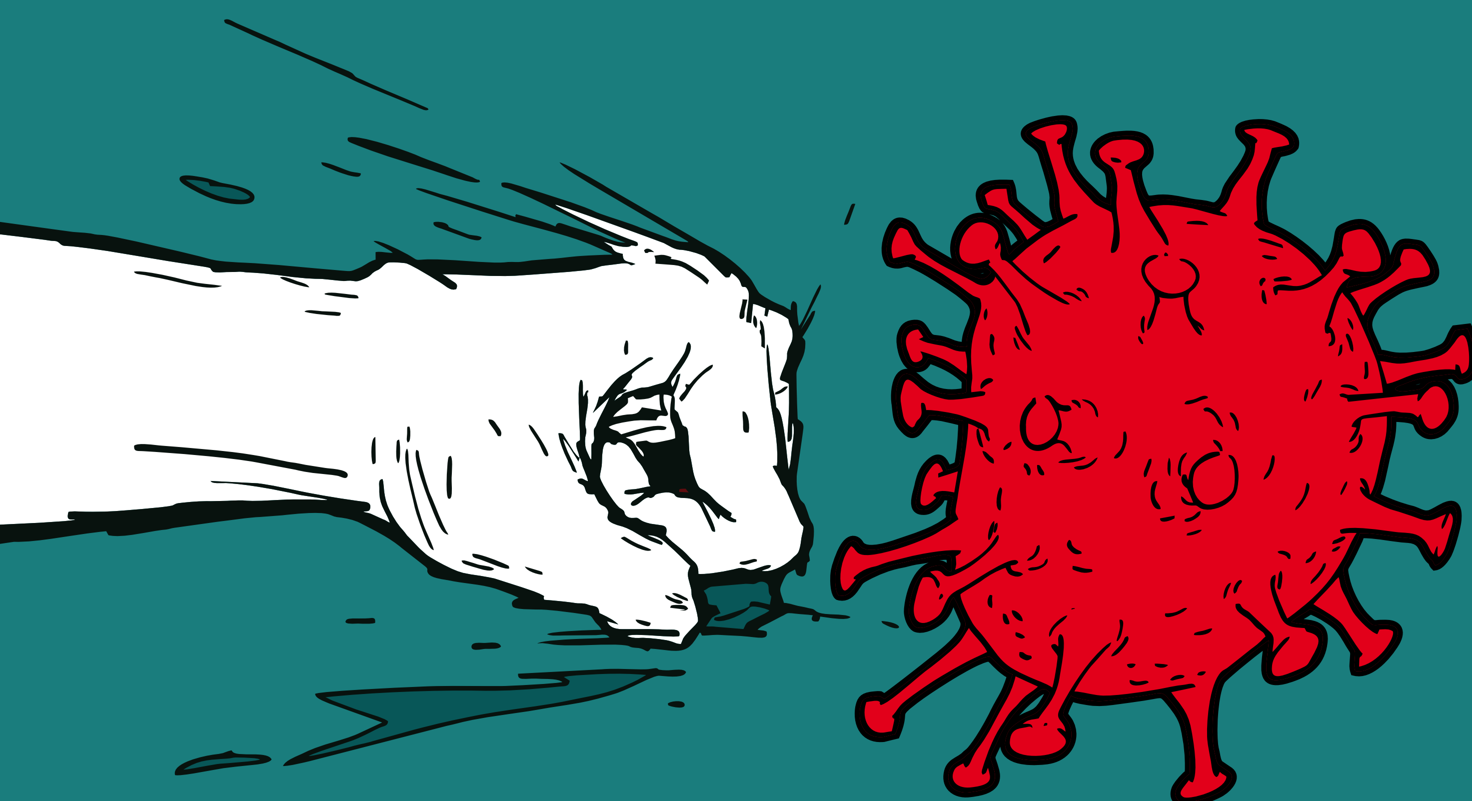

Winning the Battle and the War

Wresting fatigue determines whether this crisis marks your finest hour or the darkest day.

Sustainable Lending: The New Normal?

THE POST-COVID OPPORTUNITY FOR BANKS

WHEN OPEN BANKING BECOMES A REALITY

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ASIAN INSTITUTE OF CHARTERED BANKERS

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Editor's Note

'Such as We Are, Such Are the Times'

From trading desks to lending divisions, this issue of *Banking Insight* invites readers to think about managing volatility. Not just for the next quarter or upcoming financial year, but to 'go long' and suit up for the impending recovery.

I am deeply aware that many teams are overwhelmed doing things they never thought they had to do. Which is why *Winning the Battle and the War*, our cover story on page 12, shines a light on 'war room fatigue' – a scientifically proven phenomenon with real consequences on the human psyche – which many are feeling after months of firefighting the effects of the pandemic. Drawing on the latest research and techniques which have helped build the resilience of troops in the trenches, we trust that bankers will benefit the same from applying it with their teams.

Our featured Chartered Banker, Datuk Nora A Manaf, Group Chief Human Capital Officer at Malayan Banking Berhad, who is also a member of the Asian Institute of Chartered Bankers' Board of Examiners, talks about the science of building people to which she has dedicated her 25 year career. In a brief dialogue, she captures the essence of her philosophy which has earned her recognition as one of the Top 50 Human Resource Professionals in the world.

We take the bull by the horns in *AML Hanging on a Wire* and address financial institutions' lacklustre performance on the anti-money laundering and counter-terrorism financing front. I acknowledge that this reality check may not be kosher to all, but it is our duty to red-flag bankers on issues that will negatively impact economic recovery and are counter-intuitive to the goals of sustainability and resilience. Banking has emerged relatively unscathed from the current crisis in good part due to Basel-era reforms; we should not let these hard-won gains slip through our fingers.

While some contemporaries may regard blockchain expert Roberto Capodieci of Blockchain Zoo as an unconventional mind, his work has helped law enforcement agencies across the world unravel *mafiosi* networks and others of the same ilk. In a frank interview, *Savant or Subverter?*, he talks about the imperative of getting fintech right if banking is serious about wresting financial crime and terrorism financing.

In *The Quandary of Digital Payments*, Dr Eli Remolona, Professor of Finance and Director of Central Banking at the Asia School of Business, draws from his wide-ranging regulatory experience and provides an introduction to the major questions every financial institution will encounter, if they haven't already. He primes us on the potential "three futures" which banking could see in the coming years.

In his wisdom, the philosopher St Augustine said, "We are the times: such as we are, such are the times."

In both good times and in bad, we create our reality. Our thoughts, words, and actions shape who we are, the quality of our relationships, and the strength of our communities. The way our industry has come together is a good indication that we're on the right path. All that's left is to follow through.

Like every curveball, banking must anticipate and get into position for the economic rebound.

Be sure to catch the ball when it does. ✱

The Editor

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BANKER OF THE FUTURE

The Asian Institute of Chartered Bankers' *Empowering Bankers Webinar Series* continues with one of its most recent sessions, a collaboration with the Financial Services Institute of Australasia which focused on the profile of a future banker.

Jim Christodouleas, Banking and Capital Markets Solutions and Capability Leader at PwC Australia, set the tone for the 200-strong attendees: "[We're] not here to talk about succeeding as a banker in the world of Covid

New Ways to Invest in People & Planet

The Organisation for Economic Co-operation and Development (OECD) launched its latest report, *Global Outlook on Financing for Sustainable Development 2021: A New Way to Invest for People and Planet,* on 9 November 2020 with estimates of the looming shortfall in financing for Sustainable Development Goals due to the economic impact of the Covid-19 crisis. The analysis also includes shortcomings in international and domestic financial and taxation systems that hold back investment in sustainable development.

Speaking from Paris, OECD Secretary-General José Angel Gurría's keynote was streamed live with an ensuing discussion regarding public finances, foreign direct investment, portfolio investments and remittances, as well as ongoing

COVID-19's impact on the SDG financing gap in developing countries is devastating...

USD 2.5 TRILLION › SDG unmet financing needs annually before COVID-19

USD 01 TRILLION › Additional needs for COVID-19 spending in 2020

USD 700 BILLION › Drop in external private resources in 2020

...and yet, aligning 1.1% of US$379 trillion in global finance with the SDGs could fill that gap

Source: OECD

tax evasion and illicit financial flows. The report highlights ways in which the financial system continues to fuel inequalities and unsustainable investments.

"Even before Covid-19, SDG financing was falling short with an estimated annual gap of US$2.5 trillion and developing countries face an estimated gap of US$1 trillion in Covid-19 emergency and response spending," states Gurría.

"We need urgent action to shift the balance in favour of sustainable and inclusive development." ✱

SWAPPING OUT OF LIBOR

Reports that rigging of the London Interbank Offered Rate (LIBOR) may have existed as far back as 2003, yet the continued reliance of global financial markets on the benchmark interest rate poses clear risks to global financial stability.

The July 2020 report by the Basel Committee on Banking Supervision and Financial Stability Board (FSB), *Supervisory Issues Associated with Benchmark Transition,* reiterates that the "transition away from LIBOR by end-2021 requires significant commitment or in the world of virtual work … What we want to talk instead is a much broader perspective of what you need to do as you think about building your skills in the decade ahead."

"Maybe you're just starting your career or if you're a leader in the industry looking to hop, hire, recruit, or nurture talent and retain talent; what are the things you're going to need to think about and how might those things be different from what you might [generally] consider."

The live chat and Q&A with panelists from PwC, National Australian Bank, Judo Bank, and FINSIA covered diverse subjects and includes practical knowledge on cultivating the knack for data crunching and the craft of risk management.

Access to the recording is available for members at *https://member-portal.aicb.org.my/login*. For updates on the AICB's upcoming webinars, please visit *https://www.aicb.org.my/thought-leadership/events/upcoming/*. ✱

E-RMB GIVEAWAY

The People's Bank of China has given legal tender status to the concept of a digital renminbi on par with its physical currency. The republic's draft Banking Law paves the way for widespread adoption of the state-issued digital currency, including a ban on the issuance of substitute digital tokens. Tests have been underway in at least four cities, including a public trial of 50,000 residents in Shenzhen who were gifted *ang pows* or 'red packets' of the digital currency to spend in selected stores. An estimated 4 million transactions valued at US$299 million have been made since. ✱

LATEST BAG OF TRICKS FOR CYBER RESILIENCE

In light of increased risks to cybersecurity, the Financial Stability Board issued two new G20 reports – *Effective Practices for Cyber Incident Response and Recovery: Final Report* and *Cyber Resilience Lexicon* – to assist standard-setting bodies, financial institutions, and international standards organisations in effectively addressing threats to the stability of the global financial system.

The lexicon supports cross-sector common understanding of relevant cybersecurity and cyber resilience terminology, whilst the toolkit contains a checklist and 49 best practices for effective cyber incident response and recovery across seven components:

- Governance;
- Planning and preparation;
- Analysis;
- Mitigation;
- Restoration and recovery;
- Coordination and communication; and
- Improvement.

Whilst many of these effective practices are already in use by larger organisations, they could also be valuable for smaller and less complex organisations to help strengthen their cyber resilience. ✱

and sustained effort from both financial and non-financial institutions across many jurisdictions."

The survey also notes that although non-FSB jurisdictions are less likely to foresee significant risks in LIBOR transition, mainly due to perceptions of less frequent use of LIBOR in their financial systems, low overall exposures to LIBOR do not necessarily indicate low levels of risk. Disorderly transition by some key market participants with substantial exposures could have spillover effects. Jurisdictions identified a range of risks which could arise from disorderly transition, some of which (e.g. operational risk) would apply regardless of the size of exposures.

Contextually, Sukh Deve Singh Riar in the September issue of *Accountants Today*, puts Malaysia's exposure to LIBOR risk at approximately US$200 billion and warns that "the ramifications of LIBOR discontinuance can be chaotic and extremely challenging if not managed diligently". ✱

Central Bank Backs Gig Economy Boost

The gig economy – independent operators or contract workers hired for gigs or project-based jobs – represents approximately 26% of Malaysia's workforce, according to the World Bank, and is an important component to a sustainable economic recovery.

To improve the financial health of gig economy workers, the Financial Innovation Gig Economy Challenge was launched in March 2020 by Bank Negara Malaysia, in partnership with APEC Malaysia 2020, Malaysia Digital Economy Corporation, and the United Nations Capital Development Fund.

Malaysia served as a testbed to refine these emerging ideas and to improve the financial health of gig workers in the Asia-Pacific region.

The challenge, which leveraged digitalisation to enhance the business viability of gig workers, courted over 100 global submissions with 10 teams making the shortlist for an intensive eight-week bootcamp and innovation programme. The top three finalists – PAY:WATCH, Versa and GetHyred – showcased their promising solutions at the APEC Virtual Finance Ministers' Meeting on 25 September. ✱

CRIME-AS-A-SERVICE ECONOMY

Europol's *Internet Organised Crime Threat Assessment 2020* sounds the alert on the rise of Cybercrime-as-a-Service (CaaS) on the Dark Web. CaaS enables even technically inexperienced criminals to execute campaigns by providing exploit kits, access to compromised systems, and vulnerable remote desktop protocols.

Since Covid-19, criminals piggyback on the increasing use of encrypted email, messaging apps, privacy oriented policies, and virtual private networks in order to hide their activities and obfuscate law enforcement.

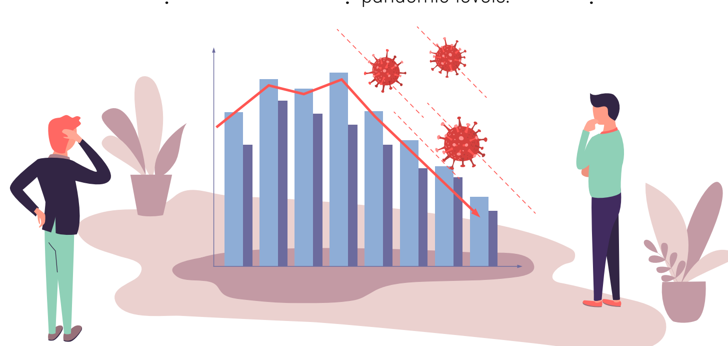
Dark Web alliances allow for more evolved threats in banking, including smishing, social engineering, and advanced malware which target broader banking functions.

IMF BAROMETER

	Projected Growth		
	2019	2020	2021
Global	2.8%	–4.4% (+0.8%#)	5.2% (–0.2%#)
Advanced Economies	1.7%	–5.8% (+2.3#)	3.9% (–0.9#)
Emerging Market & Developing Economies	3.7%	–3.3% (–0.2#)	6.0% (+0.2#)

Uncertainty in baseline projection is unusually large. Forecasts are dependent on:

- Public health response and associated domestic activity disruptions.
- Extent of global spillovers from soft demand, weaker tourism, and lower remittances.
- Vaccines, treatments, and changes in the workplace to reduce transmission could allow activity to return more rapidly to pre-pandemic levels.
- Extension of fiscal countermeasures into 2021.



NOTE: #Difference from June 2020 *World Economic Outlook* forecast.

SOURCE: International Monetary Fund, *World Economic Outlook: A Long and Difficult Ascent*, October 2020. ✱

We're delighted to catch up with Chartered Banker, **DATUK NORA A MANAF**, Group Chief Human Capital Officer at Malayan Banking Berhad and member of the Board of Examiners at the Asian Institute of Chartered Bankers. With 25 years of talent management experience and recognition as a Global Top 50 Human Resource Professional, her insights into the science of building people is a steer for Chartered Bankers to embody the gold standard of the profession.

BANKING IS ABOUT Expanding the Possibilities of Humanity

Reporting by the Banking Insight Editorial Team

Q ***The unprecedented scale of the pandemic marks an opportunity for banks to rebuild their reputations and redeem public trust. Inclusive and responsible banking, a hallmark of every Chartered Banker, must come to the fore. How do you suggest bankers help steer public opinion in the right direction?***

In essence, bankers need to take a leadership role and utilise their banking services, products, and relationships to support and accelerate the fundamental changes necessary to achieve shared prosperity for all stakeholders. These economically dire times are also when banking institutions can demonstrate placing community needs upfront, e.g. through reliefs such as moratoriums, targeted loans, or other aids such as donations.

Crisis aside, change has always been afoot though, with consumption patterns and business culture disrupted by millennials and Gen Z, rapid digitalisation, and economies striving to go greener. With that, banks and individual bankers too need to outline and uphold their role and responsibilities in shaping a sustainable future through acts such as inclusive, customer-centric services, and responsible lending and investing.

At the root of it, as the saying goes, "You can't build strong buildings without strong foundations". Similarly, bankers must be impeccable in their professional conduct, with a deeply ingrained culture of integrity, underpinning the tenets of responsible banking in order to uphold public trust. A crisis such as the pandemic only serves to heighten this aspect even more, with the public facing economic disruptions and an uncertain future.

In the long term, through their support of society, customers, and communities by facilitating the changes required for sustainable and socially purposeful finance, banks and bankers are then able to

continuously put up the building blocks for public trust, supported by governance and transparency. Providing service solutions and products that align with environmental, social and governance (ESG) criteria is critical moving forward, for this generation and the next.

Q ***A financial steward is one who has the dedication and discipline to protect the long-term interests of others. What is your personal ethos or philosophy in ensuring this value is retained for clients?***

Most may perceive businesses, including banking, to be only about profit, but at its best, it is about expanding the possibilities of humanity, by being a responsible corporate citizen. That's why to me, putting profits before all else, especially anything that can potentially jeopardise the livelihoods of our clients or employees, even if it benefits some stakeholders, is an absolute no-no. Doing the right thing, which includes ensuring customer rights are preserved, I believe is a discipline that is to be upheld at all times, especially as a banker.

As a humanising banker, we anticipate customers' and society's needs, hence the creation of products and services that cater to their needs no matter the environment. Even more so at times of crisis such as the current pandemic. For example, for us at Maybank, one of our efforts was through empowering the community to make a living via the *Sama-Sama Lokal* platform. Originally launched to help local hawkers who were facing difficulties amidst the Movement Control Order (MCO), the platform evolved as recovery mode kicked in to include a wider range of businesses. To further help preserve the safety of customers and the community, we also introduced Maybank EzyQ, an online appointment management system that enables customers to lessen their waiting time and prioritise personal safety.

Ultimately, preserving the long-term interests of others means our business continuity practices must be in line with ESG considerations as a whole. This reinforces the hallmark of Chartered Bankers at the helm, where giving due care and consideration to others is also an exemplary trademark. For us, among our considerations, were the ESG commitments in our investments, particularly through Maybank Asset Management, where we have invested in the Malaysian ESG Opportunity Fund, an ESG equity growth fund. Another is the first actively-managed *Syariah*-compliant ESG fund, the Maybank Global Sustainable Equity-I Fund, which is a global equity fund that adopts ESG factors to enhance long-term returns.

Fundamentally, an all-round approach is needed to effect long-term change; it also has to be collectively done as an industry.

Q ***In your opinion, how has banking changed throughout your career in financial services?***

From my observations, the main change has been that today, digital is now mainstream. Banks are now acting as technology companies that provide financial solutions – unheard of as recent as 10 years ago. With the advent of digitalisation, entire industries have undergone massive changes, including banking and now with the pandemic, this has almost revolutionised business models that were slower to respond in the past. We are already seeing alliances between financial services and technology companies, using robotics and artificial intelligence to address key pressure points, reduce costs, and mitigate risks. Non-banks are driving new business models. The industry is looking far beyond just replacing the bank teller.

Another change in the industry, is the emphasis on diversity and inclusion. Apart from strides taken in the industry in this respect, I always share with pride that at Maybank too, resulting from our continued efforts and focus to develop and retain women talents since the start of Maybank's people transformation journey commencing 2009, we have also seen encouraging results for women representation in board and management. An example is our former chairman, Datuk Mohaiyani Shamsudin, who was the first woman chairperson of the country's largest bank in 2017 and compared to 38% in 2009 when our people transformation journey commenced, women in management has trended upwards to 47% in 2019 as a result of the stringent monitoring, targeted, and varied interventions emplaced through the years.

With the advent of digitalisation, entire industries have undergone massive changes, including banking and now with the pandemic, this has almost revolutionised business models that were slower to respond in the past. **WE ARE ALREADY SEEING ALLIANCES BETWEEN FINANCIAL SERVICES AND TECHNOLOGY COMPANIES, USING ROBOTICS AND ARTIFICIAL INTELLIGENCE** to address key pressure points, reduce costs, and mitigate risks.

Q ***What strategic imperatives must banks invest in to achieve operational resilience?***

More than ever, I feel that effective and dynamic organisational development is critical to support the business continuity of organisations. As a human resource practitioner, identifying pain points, anticipating the growing needs of the business – it all ties back to ensuring a workforce that is future-ready and resilient enough to face an increasingly VUCA (volatile, uncertain, complex, ambiguous) business landscape.

Lifelong learning and empowering the workforce to take charge of their own development is crucial in this respect. Additionally, adapting and being agile are mandatory, and that includes business processes. For example, having a mobile workforce is now a new normal, and for us, we had already gone through the first hurdle in the early stages, i.e. going straight to 82% work-from-home in the first week the MCO was announced, made possible due to our future-ready initiatives prior to the pandemic.

We have now levelled up further with our mobile work arrangement, where work is redefined – it is not anchored to a place or time-based, but on how we can deliver our very best for our customers, wherever we may be. Empowering the workforce, in addition to safeguarding the safety and well-being of employees, ultimately strengthens organisational resilience. ✱

WINNING THE BATTLE AND THE WAR

By Angela Yap Siew Peng

- WRESTING FATIGUE DETERMINES WHETHER THIS CRISIS MARKS YOUR FINEST HOUR OR THE DARKEST DAY.

Make no mistake, war-room fatigue is real and dangerous.

After almost a year since the outbreak, many teams are still on the ground 24/7. Top-of-mind are two mantras: protect the health of employees and customers, and ensure business continuity.

In pursuit of these objectives, command-and-control centres have been set up comprising key operational talents with a remote or on-site global view of the situation. These responders are technically empowered to plan and execute the 'tough calls' needed to manage the crisis at hand.

Welcome to banking's war room, a Lean Six Sigma practice touted as the solution to our crisis-management age. Governments use it, regulators have deployed it, and many corporates swear by it.

Whether the objective is to cost down, provide liquidity for survival, or retool the business for the impending recovery, every established management consulting firm extols its virtues. Yet, just like post-traumatic stress disorder for soldiers in combat, few talk about the long-term effects of war room and crisis management on the psyche and well-being of people who work under high-stress conditions.

In pursuit of these objectives, command-and-control centres have been set up **COMPRISING KEY OPERATIONAL TALENTS WITH A REMOTE OR ON-SITE GLOBAL VIEW OF THE SITUATION**. These responders are technically empowered to plan and execute the 'tough calls' needed to manage the crisis at hand.

GEARING UP

Adopted from the military practice of establishing bunker-like operational hubs where generals and strategists exchange by-the-minute reports and plan tactical manoeuvres, war rooms have been deployed for decades among project management professionals tasked with resourcing and executing critical programmes such as change management.

In the business world, the war room is no place for the faint-hearted. More than just a term to be bandied around, setting up a war room is not a guarantee that one will emerge unscathed. The real game-changer is the mindset shift that accompanies it. In the context of today's risk-ridden world, banking's war room – whether to address cybercrime or navigate a crisis – must be populated with individuals who thrive on the adrenaline and are confident to make rapid-fire decisions.

Almost all banks today have working war rooms in place, but typical project war rooms are highly intense and supposed to last only a period of two or three weeks. With Covid-19, some banks, especially in Asia where many of the earliest responders are situated, their war rooms have been operational for months.

FEELING ALONENESS IN A CROWD

In a May 2020 article published by *Harvard Business Review*, prominent business psychologist Dr Merete Wedell-Wedellsborg warns: "I see this war-room fatigue in the leaders right now — and in their teams. It's real and it is infectious, and it hits you like a hammer from one day to the next."

Her feature, *If You Feel Like You're Regressing, You're Not Alone,* documents the surreal and cyclical experience of leaders who have yet to manage a bigger crisis than Covid: "In my experience as a psychologist and executive advisor, I've found that crises follow a rough pattern: Emergency. Regression. Recovery."

An understanding of the symptoms that demarcate each phase helps leaders and team members identify their current state and hopefully circumvent a meltdown.

Dr Wedell-Wedellsborg writes: "In the beginning, when the emergency becomes clear, team energy rises, and performance goes up. Almost all of us have unknown reserves. As the executives' experiences reflect, this reaction feels full of purpose and much gets done. Leaders tend to become the best version of themselves in this phase and teams instinctively pull together and become highly productive. Few people question the leaders' authority, and teams work in hectic, but harmonious, ways. The urgency created by the shock paves the way for rapid decision-making and turbocharges teams' bias for action.

"Then the second phase hits: a regression phase, where people get tired, lose their sense of purpose, start fighting about the small stuff, and forget to do basic things like eat or drink — or they eat and drink too much.

"The concept of regression comes from developmental psychology and describes how people roll back to a less mature stage when faced with pressure. Regression is one of the mind's ways to defend itself from confusion and insecurity by retreating to an emotional comfort zone.

"From combat psychology in particular, we know that regression is the most dangerous phase for teams. The most stressful events for soldiers don't actually involve dangerous missions that require courage and action. They actually involve waiting: being in the middle of nowhere on a post, repairing equipment and handling administrative tasks, not being able to use their particular skills. It turns out that boredom, lack of new experiences, and monotony can be much more stressful than combat.

"The regression phase is uncomfortable. It's also unavoidable and cannot be skipped. Understanding what the phases looklike and how you can move through the toughest part of crisis will help you mitigate the performance drop.

"The challenge for leaders is to pull through the regression phase in a constructive way and get to the recovery phase to reopen, rebuild, and prepare for the future."

GET OFF THE DANCE FLOOR AND GO TO THE BALCONY

What can leaders do to successfully transition to the recovery phase after fatigue has set in for both themselves and their teams?

Ronald Heifetz, one of the world's foremost authorities on leadership, and his colleague Marty Linsky, professor at Harvard University Kennedy School of Government, advise that leaders take what they've termed 'a balcony perspective' and 'go long' in their vision whenever teams go off tangent:

They propound: "The ability to maintain perspective in the midst of action is critical to lowering resistance. Any military officer knows the importance of maintaining the capacity for reflection, especially in the 'fog of war'. Great athletes must simultaneously play the game and observe it as a whole. We call this skill 'getting off the dance floor and going to the balcony', an image that captures the mental activity of stepping back from the action and asking, "What's really going on here?"

The emphasis that leadership is "an improvisational art" is comforting, especially when it is too often simplistically packaged as a neatly prescribed science. Truth be told, even Peter Drucker's golden maxim of managing by walking around won't do much good if one lacks the responsive qualities expected of a leader.

In an era obsessed with quantifying of everything, it is empowering – indeed, liberating – when overwhelmed leaders are told that there is no moment-to-moment script when wading in unchartered waters. There is only the belief in vision, values, and dedication to see things through.

QUANTUM DAWN SIMULATION

HOW BANKING'S WAR-ROOM MINDSET BUILDS OPERATIONAL RESILIENCE

THE MILITARY sharpens soldiers' skills with large-scale combat drills like Jade Helm and Foal Eagle, which send troops into the field to test their tactics and weaponry. The financial sector created its own version: Quantum Dawn, a biennial simulation of a catastrophic cyber strike.

In the latest exercise in November, 900 participants from 50 banks, regulators and law-enforcement agencies role-played their response to an industry-wide infestation of malicious malware that first corrupted, and then entirely blocked, all outgoing payments from the banks. Throughout the two-day test, the organisers lobbed in new threats every few hours, like denial-of-service attacks that knocked the banks' websites offline.

The first Quantum Dawn, back in 2011, was a lower-key gathering. Participants huddled in a conference room to talk through a mock attack that shut down stock trading. Now, it is a live fire drill. Each bank spends months in advance recreating its internal technology on an isolated test network, a so-called cyber range, so that its employees can fight with their actual tools and software. The company that runs their virtual battlefield, SimSpace, is a [US] Defense Department contractor.

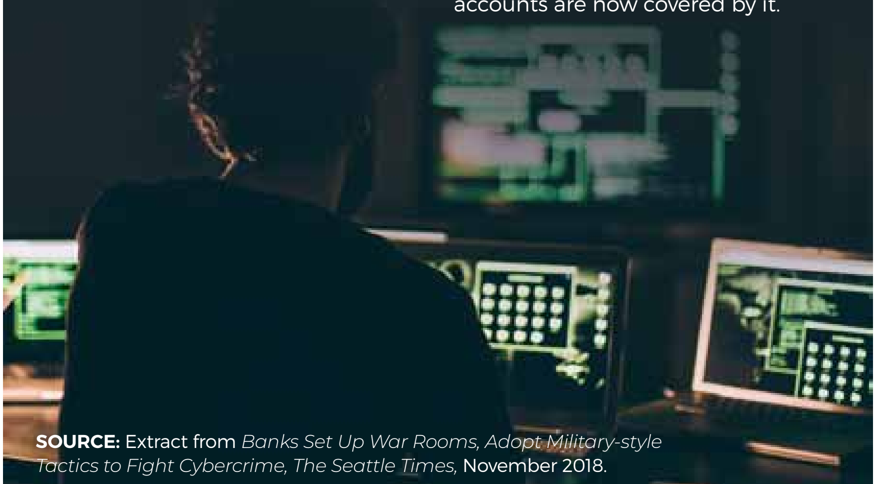
Sometimes, the tests expose important gaps.

A series of smaller cyber drills coordinated by the Treasury Department, called the Hamilton Series, raised an alarm three years ago. An attack on Sony, attributed to North Korea, had recently exposed sensitive company emails and data, and, in its wake, demolished huge swathes of Sony's Internet network.

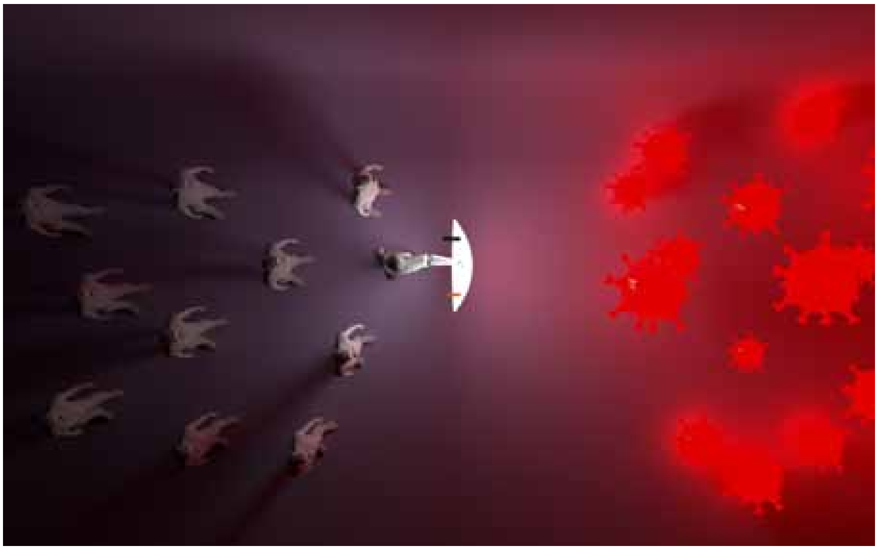
If something similar happened at a bank, especially a smaller one, regulators asked, would it be able to recover? Those in the room for the drill came away uneasy.

"There was a recognition that we needed to add an additional layer of resilience," said John Carlson, the chief of staff for the Financial Services Information Sharing and Analysis Center, the industry's main cybersecurity coordination group.

Soon after, the group began building a new fail-safe, called Sheltered Harbor, which went into operation last year. If one member of the network has its data compromised or destroyed, others can step in, retrieve its archived records and restore basic customer account access within a day or two. It has not yet been needed, but nearly 70% of America's deposit accounts are now covered by it.



SOURCE: Extract from *Banks Set Up War Rooms, Adopt Military-style Tactics to Fight Cybercrime*, *The Seattle Times*, November 2018.



"You must respond as events unfold. To use our metaphor, you have to move back and forth from the balcony to the dance floor, over and over again throughout the days, weeks, months, and years.

"While today's plan may make sense now, tomorrow you'll discover the unanticipated effects of today's actions and have to adjust accordingly. Sustaining good leadership, then, requires first and foremost the capacity to see what is happening to you and your initiative as it is happening and to understand how today's turns in the road will affect tomorrow's plans."

BEAT SNAFU

Premier Jacinda Ardern's lockdown strategy for New Zealanders was simple: Go hard, go early. For banking, we recommend you add "go back to the drawing board" in your arsenal toolkit for crisis survival.

The ultimate goal of responsive leadership is resilience, the goal that banking has been preparing itself for almost a decade since the global financial crisis (GFC). The words may be different but the message is the same: stay clear of a SNAFU (the military acronym for 'Situation Normal All F*&%#d Up").

War-room strategies may win you the battle, but not necessarily the war. Post-GFC, just as the then Bank of England Governor Mark Carney urged G20 policymakers not to give in to the stress of "reform fatigue", modern-day war rooms must be ever vigilant of signs of crisis fatigue in their workforce and pre-empt its damage to morale, performance, or in some cases, survival.

> ***Defining Resilience:*** *The US Army and Mindfulness* published by Thrive Global, outlines some surprising techniques from a 10-day Master Resilience Training developed for the army with the University of Pennsylvania and deployed to its 300,000-strong corps and their families:

> **'Hunt for the good stuff'.** One of the first modules of the training and an exercise in which participants are encouraged to search for and focus on what they can be grateful for. This exercise is designed to promote personal optimism and fight the negativity bias, an essential to the development of personal resilience.

"The regression phase is uncomfortable. It's also unavoidable and cannot be skipped. Understanding what the phases looklike and **HOW YOU CAN MOVE THROUGH THE TOUGHEST PART OF CRISIS** will help you mitigate the performance drop.

> **Mindfulness.** In 2014, authors of an *American Journal of Psychiatry* study showed that US Marines who had undergone eight weeks of mindfulness training clocked reduced activity patterns in regions of the brain responsible for integrating emotional reactivity and cognition and interoception (an awareness of the internal state of the body). The research proves that mindfulness training "can help Marines recover from stress and return to baseline functioning more quickly". This corroborates other research which prove that cultivating mindfulness enhances emotional control, supports more informed decision-making, improves perspective, and preserves stronger social networks, which in turn promotes individual resilience. Similar mindfulness training is also increasingly being taught to uniformed officers, including the British Royal Navy, Army, and Royal Air Force as well as the New Zealand armed forces.

> **Meditation.** In the military, they utilise a form of 'focused attention' meditation – this could be a mantra (a word, phrase or sound that is repeated) or visualisation or even focused breathing. Whilst relatively new to the armed forces, this type of focus training is widely practiced in most Eastern cultures from China to India. By zoning in on something, you are focusing on nothing else. In the long term, this helps slow down racing thoughts, making you think quicker, clearer, and more flexibly adapt to rapid changes.

Next time, before you log in to that virtual meeting room or email a client, do a quick mental check to make sure you're in the right headspace. If not, take a moment, perch 'on the balcony', and breathe. As a friend once told me, a change of view is as good as a holiday.

Then, when you're ready, strap on those combat boots…and go. ✱

■ *Angela Yap Siew Peng is a multiaward-winning entrepreneur, author, and writer. She is Director and Founder of Akasaa, a boutique content development firm with presence in Malaysia, Singapore, and the UK and holds a BSc (Hons) Economics.*

Roberto Capodieci

SAVANT OR SUBVERTER?

By Angela Yap Siew Peng

Whichever you choose to believe, this blockchain expert isn't mincing his words.

Of the technologies touted to shift the world, blockchain ranks at the top of the list and Roberto Capodieci is at its forefront. The founder and CEO of Blockchain Zoo is recognised as one of the first-movers in the technology and a specialist in lawful interception systems.

In 1980, at age six, Capodieci taught himself to code when his father brought home the world's first pocket computer, a Sharp PC1210. At age 10, he developed and sold his first video game software. By 1988, he had started his first company by developing a system for optical archiving and document sharing. All this by the 'ripe old age' of 14.

Described as possessing "a rare combination of business acumen and deep tech skills" by Matteo Rizzi, Europe's top 40 most influential fintech figures, Capodieci is set to launch ZooBC, a technology platform currently in beta stage to make blockchain more stable, secure, and scalable for everyone.

Q ***Your involvement in software development goes back to the early 1980s, in the days when many people hadn't even heard of computers. How did your journey in computing evolve from teenage obsession to a near four-decade career?***

Actually, my specialisation in consulting for law enforcement agencies (LEAs) began when somebody tried to rope me into international drug dealings.

Back to how it all began. I love mathematics, a trait that runs in the family. When I was young, my father showed me a pocket computer. The machine asked, "What's your name?" and when I wrote 'Roberto' it interacted with me. It would say something nice to me or if I didn't answer with my name, "I don't want to talk to you". I was shocked at how this could happen. Then I saw the code and took the machine away from my father.

This was how I learned to code in BASIC (the programming language in the 1980s). That was my first deep exploration into the 'brain' of a computer, and my parents supported this passion, or at least it was like a jump in the dark, because no one thought the computer would be an everyday part of life like it is today. At the time, it was just a toy or something strange.

As a teenager, I ran a profitable business cloning computer games. In the early days, there were no piracy or copyright laws when it came to video games because it was so new. So I was distributing computer games and always had kids coming over to my house to collect their floppy disks. One day, someone approached me and said: "Hey, I heard you have a talent for distributing things. Do you want to become part of selling cocaine?"

I was shocked but he was serious. So I said I'd think about it, then I went to the police and told them that about this guy. They introduced me to the anti-drug department, we did a big drug bust operation, and I became friends with the officers from the anti-drug unit in the northeast of Italy.

Once, when I was with them, the officers were sitting around the table with a highlighter, each with a huge pile of paper. They were checking telephone numbers – who called who – by hand. I said, "Are you crazy? You should use a computer, it is faster." They didn't know what I was talking about.

We went to the phone company but the company didn't have a way to export the information in digital format. So I implemented the first software to digitally collect and analyse phone records so that the police could track who called who, extrapolate the social network of the criminal organisation, identify who was potentially the boss, determine where people slept at night, and even where they would meet using data from cellphone towers.

That was almost 30 years ago. At the time, the work was pioneering. Today, this is normal and it is a huge industry, but back then it was revolutionary. That's how I began my career as a consultant for LEAs and other government agencies. Since then, I've implemented software like optical archiving, documentation management, and big data analysis for both law enforcement and the private sector.

Q ***You specialise in mobilising blockchain to wrest financial crime and terrorist activity. Can you give us a practical example of how it works?***

Essentially, blockchain can be used to enforce rules in the flow of documentation, guaranteeing that such rules cannot be bypassed or cheated. Offering full transparency and being an incredible tool for auditing, blockchain is a building block for systems of the current phase in the information age.

Yet blockchain is just a tool, not a finished system. It's another type of database, but a very cool one that allows many parties to work together, to share data, and guarantee the quality of that data.

In the fight against financial crimes, white collar crimes, and corruption, it is paramount to move from paper to digital documents, managed by a system that is impossible to cheat. For example, the approval for the release of information can be pre-programmed in the blockchain, so that it reflects the flow of bureaucracy; there will be no need to make calls to get information. Instead, the chief will release the information using a digital signature and then allow the process – the flow of bureaucracy pre-programmed in the blockchain – to follow.

Cryptography, which is heavily used in blockchain software, also allows encryption, which is a key to privacy and partial disclosure of data. In law enforcement and investigations, sometimes there is secrecy even between an agent and the one sitting next to him. Security protocols require a lot of sealed compartments. Information needs to be highlighted if there is a common trend between two investigations, because you don't want people to do the work twice, but it must be done in a way that avoids leaks or raising red flags to the wrong person..

When many parties work together, it is paramount to have a platform which guarantees that the flow of paperwork goes smoothly and all the needed steps are done properly. Blockchain systems can be programmed so that the information flow happens only if everyone respects the rules.

Q ***What if the gatekeeper, the one who has a master key or access, is compromised?***

The question isn't whether blockchain is automatically safe or not. Whoever implements a blockchain-based system needs to have a solid understanding of its foundations because it doesn't work like a centralised database. There is the need to architect it properly. When there is illiteracy about the mechanics of a decentralised system, the architects don't even realise that they're creating huge problems. Blockchain is not as efficient as a centralised database and it cannot be used or programmed with the same mentality.

Many people don't know the difference. In a centralised system, to access data, you connect using a username and a password sent over the Internet to the server. The server has a table with usernames and passwords; it checks if those sent by the user match, and if it does, allows the user to view the authorised part of the data in the system.

However, in decentralised mechanics, one cannot use the 'username and password' authentication method because without a central server, there would be the need to have the table with all the usernames and passwords in each node of the peer-to-peer network, exposing everybody's username and password to whoever runs a node. This is not secure at all.

In a decentralised system, users must authenticate themselves using cryptography, i.e. generating a private key (a secret code that is not to be shared with third parties). With the private key, the user then generates a public key and uses it as his/her identity. With the user's public key, a document, and the user's cryptographic signature, users (and any properly coded software) can verify the authenticity of the signature.

Q ***There is a lot of hype surrounding blockchain. Do you see any negative impact of this in terms of implementation in the real world?***

The hype does more damage than good, especially since I find a lot of things such as initial coin offerings [in cryptocurrency] to be unethical. For sure, there is also a lot of confusion between people who claim to know about blockchain and those who actually do. I attend a lot of speeches, some very specific on blockchain, and sometimes people who step on the stage have much more charm and speak better than I do, but what they convey about blockchain and the technology is fundamentally wrong.

We once met a client who had spent millions of dollars implementing a blockchain-based system for his company using software built by architects who made some of the biggest mistakes in decentralised systems. The architects made a server where users registered with their username and password, and then kept all the private keys inside the server, which was coded to automatically post transactions signed on behalf of the user. This goes against the basic principles of decentralisation and blockchain security.

As consultants, we explained to these developers that a user could access the blockchain directly via the peer-to-peer network and bypass their centralised restrictions. As they realised this risk, they decided to move all the nodes of the blockchain into a virtual private network. Only their gateway server could see the nodes but it was not exposed to the Internet. This was a proof-of-work blockchain in a private network. Essentially, the client was paying US$200,000 a month for mining his own blockchain. A huge, useless expense for the client.

However, the client had no idea. All he saw was the user interface: a mobile application and a website. Both were nice and worked properly. Yet, as he was using this introduction of blockchain as part of his company's business model and marketing, it exposed him to potentially bad publicity as anyone with the minimum knowledge of blockchain would've seen the architecture and thought: "Oh my god!".

We ended up training the developers of this software house about the correct fundamentals and philosophy of blockchain and decentralised systems. This is the kind of work we do at Blockchain Zoo.

While blockchain technology is powerful and brings a lot of innovation, it is very important to be sure that developers understand the requirements well before stepping into implementation.

Q *Where do you see the future of tech and decentralised systems like blockchain?*

Currently, in a regular blockchain, when a transaction is sent to you, you receive it. This has risks. For instance, if I have an illegal source of money and I send it to you, the transaction is accepted and you are at the losing end because you could not accept or reject that transaction.

One of the big things that we're doing with blockchain is that you can set your account to refuse incoming transactions. That sounds like a simple thing but it's missing almost everywhere unless you code it into a smart contract.

Until I started Blockchain Zoo with nine other partners, there was a lot of talk about blockchain but few opportunities where people could actually sit and do it for real. The vision is to create a centre for actual blockchain knowledge and provide correct education and implementation globally. Now, after many years of tests and discovery, we're implementing our own technology platform, a project called ZooBC. For instance, let's say a consortium of hospitals want to use blockchain for their medical records, they can now licence the tech from us and start their own blockchain for that instead of building smart contracts on their own.

Ultimately, blockchain should be this underlying technology that enables everything, and yet users shouldn't even know that there is a blockchain behind what they're doing.

Q *In what direction has the outlook for blockchain evolved since the pandemic – has it accelerated or have new applications emerged? Has it impacted your own views on where the future lies for tech in finance?*

The pandemic has made blockchain much more needed than it was before. Remote work, for example, requires more auditing, guarantee on requests, documentation flow and tracking, and payment systems than a regular in-office job.

It is interesting how, many years ago, when the first decentralised file sharing system, Torrent, came out, the majors of movie and music, rather than recognising an innovative technology that could have allowed them to sell music and movies in every corner of the planet, got scared and lobbied governments to make an example of a few "pirates" to scare others from using a technology they couldn't stop. Only Apple entered the market of online music, with huge difficulties.

Likewise, financial institutions had mixed reactions to bitcoin. Some got scared, some lobbied governments to make it illegal, and others surfed the wave of innovation, adopting the technology for their own needs to eventually offer it as a service to their clients. In recent news, DBS, the largest bank in Singapore, is opening its own crypto exchange for institutional clients.

So, in my opinion, we are moving toward decentralisation at quite a high speed, and blockchain is a key technology that will have wide adoption, mostly outside of the cryptocurrency world. ✱

■ *Angela Yap Siew Peng is a multiaward-winning entrepreneur, author, and writer. She is Director and Founder of Akasaa, a boutique content development firm with presence in Malaysia, Singapore, and the UK and holds a BSc (Hons) Economics.*

AML COMPLIANCE HANGING ON A WIRE

By Julia Chong

WITH RECORD-HIGH FINES AND A LEAK MORE DAMAGING THAN THE PANAMA PAPERS, IT'S TIME BANKS GET THEIR AML/CTF PROGRAMMES BACK ON TRACK.

Between navigating the pandemic and workplace disruptions, it seems that banks are relegating anti-money laundering (AML) compliance to the backseat, a precarious position that could unravel much of banking's progress since the global financial crisis.

The October edition of *Global Enforcement Review*, an annual publication by consultancy Duff & Phelps, revealed that the first half of 2020 (1H2020) has seen a surge in global AML fines –US$706 million compared to 2019's full-year total of US$444 million. More worrying is that the fines were imposed for the same lapses over the past five years.

The trend is corroborated in a separate report by regulatory consultancy Fenergo that Asia-Pacific regulators imposed nearly US$4 billion in AML/Know-Your-Client-related fines in 1H2020 and warns that fraudulent activity arising from Covid-19-related initiatives may see further enforcement actions well into 2021.

The year has also seen some record penalties, leaving more than a dint in the industry's hard-won battle to regain public trust.

On 20 February 2019, a landmark decision handed by the Paris Criminal Court found Swiss bank UBS AG guilty on charges of aggravated money laundering of the proceeds of tax evasion and illegally soliciting clients. The offence chalked a record fine of EUR4.5 billion, a penalty which exceeds the bank's 2019 net profit of EUR3.8 billion. The bank has filed an appeal over the decision.

There is also the Wirecard scandal, dubbed 'Germany's Enron', which came to a head in June (see story on page 25) after years of red flags.

Closer to home, in September 2020, Australia's Westpac was hit hard as it negotiated with the country's financial crime watchdog to pay an AUD1.3 billion fine for breaching AML rules more than 23 million times in transactions amounting to more than AUD11 billion.

The AML crackdown isn't on banks alone. Earlier this year, the UK Gambling Commission meted a GBP3 million fine to Mr Green, an online betting company that is part of the William Hill betting empire, for serious "systemic failings" over money laundering checks. In one instance, the agency watchdog cited how the company accepted a photograph of a laptop screen showing an alleged cryptocurrency trading account as adequate proof-of-origin of money. On another occasion, the company failed to perform a customer due diligence check on a gambler who won GBP50,000, lost his winnings, and then deposited thousands more – flagging a possible case of addiction is a requirement under British law. Banks which finance the operation of casinos are expected to scrutinise their activities, including vetting casino AML processes, rejecting anonymous wire transfers, and information to assist the gaming industry in identifying risky transactions.

THE FinCEN FILES

The greatest damage in the AML sphere, however, goes beyond numbers.

In what has been dubbed 'The FinCEN Files', over 200,000 suspicious activity reports (SARs) valued at over US$2 trillion were leaked this September to online portal *Buzzfeed*, which passed on the files to the International Consortium of Investigative Journalists, the global network which exposed the Panama Papers.

The SARs, mandatory declarations triggered whenever bank staff detect potential criminal activity, were filed by global banks with the US Treasury's Financial Crimes Enforcement Network (FinCEN) between 1999 and 2017. It contained the names of fraudsters, terrorists, and suspects of organised crime, including at least one individual who was brutally murdered over a Ponzi scheme and Russian oligarchs' use of banks to avoid sanctions.

BBC states that the documents – which implicate financial institutions in more than 170 countries, governments, and supervisory agencies – show how the "world's biggest banks have allowed criminals to move dirty money around the world".

Following the revelation, US and Europe banking stocks nosedived and the

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security of AML and counter terrorism financing (AML/CTF) teams and front-line bank staff were compromised. It sparked fiery conversations as banking experts weighed in.

Rachel Woolley, director of financial crime at Fenergo, in an email response to CNBC, wrote: "Fines are on the up, over US$40 billion since the financial crisis, but is this really a deterrent to the financial institutions that facilitate money laundering? In comparison to the trillions of dollars that illegally move around, these look like a simple cost of doing business."

"The days of hiding behind complexity and paper pushing are gone, the entire industry needs to collaborate more effectively in order to adhere to policy and prevent crime from entering the financial system."

Also to CNBC, Tim Adams, President and CEO at Institute for International Finance, hoped the findings would get policymakers to enact urgent reforms to combat financial crime.

He said: "The findings of today's reports once again emphasise the need to pursue intelligence-led changes for financial crime risk management – driven by meaningful improvements to public-private sector cooperation and cross-border information sharing, coupled with the use of technology – to enhance the global anti-financial crime framework."

It isn't enough that banks cover their own tracks. With the FinCEN leaks as prime reference, at some point in time, financial service firms and governing bodies will be held accountable for failure to report or detect suspected AML/CTF breaches. If not through trial by court, then at the very least, in the court of public opinion.

NO DRAMATIC PROGRESS

Basel AML Index, published annually by the Basel Institute on Governance, a not-for-profit Swiss foundation to combat corruption, ranks 141 countries according to their risk of money laundering and terrorist financing (ML/TF). It's important to note that the calculated ML/TF score measures the risk of ML/TF in these countries, i.e. vulnerability and capacities to counter ML/TF activities, and is not reflective of the actual amount of ML/TF activity in a country.

The findings of today's reports once again emphasise the **NEED TO PURSUE INTELLIGENCE-LED CHANGES FOR FINANCIAL CRIME RISK MANAGEMENT** – driven by meaningful improvements to public-private sector cooperation and cross-border information sharing, coupled with the use of technology – to enhance the global anti-financial crime framework.

Tim Adams
President and CEO at Institute for International Finance

In the 2020 edition of the AML Index, the needle hardly budged as the global average risk score of 5.22 wasn't far off from last year's 5.39. An area in which all countries scored poorly is the quality of AML/CTF supervision. The report highlights areas that contribute to ineffective supervision:

+ **Limited powers** to sanction non-compliance by civil or administrative means. This leaves only criminal prosecution, for which the bar is typically high;
+ **Limited resources,** including qualified staff, processes, IT systems and tools;
+ **Risk-based approach is not applied,** meaning supervision is not commensurate with the risks and size of the financial centre and the number and intensity of reviews are not aligned with existing risks;
+ **Poor coordination between competent authorities** on supervision, with individual agencies focused only on their sectors; and
+ **Insufficient guidance on ML/TF risks** provided by supervisory body to reporting entities.

East Asia and the Pacific scored 5.46, slightly above the global average. Hong Kong, Japan, Singapore, and Taiwan

face the largest issues with financial secrecy and nearly half of all countries in the region are listed as major money laundering destinations. The report also highlights these areas of concern for the region:

- Weakest areas relate to the quality of AML/CTF frameworks;
- Underperformance with respect to public transparency and accountability; and
- Future reforms must focus on technical and legal adjustments as well as effective implementation.

VIRTUAL SPOTLIGHT

Of particular importance, says the foundation, is that "supervision by competent authorities of financial institutions, designated non-financial businesses and professions, and virtual asset service providers (VASPs) is a major factor affecting AML/CTF risk and resilience."

It is timely then that one of the Financial Action Task Force's (FATF) latest reports, *Virtual Assets—Red Flag Indicators of Money Laundering and Terrorist Financing,* was released on 14 September 2020 as a reference for public and private sectors to identify, detect, and prevent criminal, ML and TF activities associated with virtual assets (VAs).

VAs are defined as "any digital representation of value that can be digitally traded, transferred or used for payment. It does not include the digital representation of fiat currencies." The latest standard focuses on ensuring that transference of such digital assets are on par and held to the same level of safeguards as other assets in the financial sector.

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>
> **The Basel Institute on Governance**

For more details, we advise readers to look into the FATF's Recommendation 15 and its corresponding Interpretive Note as well as Recommendation 16 on wire transfers. The latter outlines a 'travel rule' clause requiring member nations to ensure all crypto exchanges share real-identity information with transmittal counterparties or face increased AML/CTF monitoring.

On the regulatory front, Germany and India have pushed ahead with positive developments, and South Korea is the recent to come onboard. On November 3, the country proposed the following revisions to its Act on Reporting and Using Specified Financial Transaction Information, aligning its AML requirements with the FATF standards:

- Definition of VASPs as business entities which engage in the VA purchase and sale, exchange, transfer, safekeeping, administration of virtual assets, or involving the intermediation or brokering of virtual asset transactions.
- Definition of VAs as digital tokens with economic value that can be digitally traded or transferred, which explicitly excludes digital tokens that cannot be exchangeable for fiat currencies, commodities and services and whose purpose of use is limited by the issuer.
- 'Travel rule' to apply to VASPs whereby the originating VASP must provide the beneficiary with information about the VA transfer.
- VASPs to use real-name accounts in their financial transactions and adhere to the following additional requirements in order to open real-name accounts with financial institutions (FIs): separation of customers' deposit, obtain a certificate of Information Security Management System from the Korea Internet & Security Agency, no record of fines or penalty in the past five years, and submit to assessment of ML risks

conducted by FIs.

- VASPs must undergo money laundering risk assessments by banks to open an account.

The final revisions are scheduled to come into effect on 25 March 2021, with the exception of the travel rule which will only apply from 25 March 2022 to allow VASPs sufficient time to introduce common solutions for information sharing.

Despite this, authorities are mindful that regulation must be balanced in order to encourage innovative technologies such as blockchain – the foundation of cryptocurrency and virtual assets – to flourish.

It is important to note that a risk-based approach does not imply that banks should automatically view VAs and VASPs with suspicion. The FATF advises:

"It is important that FIs apply the risk-based approach properly and do not resort to the wholesale termination or exclusion of customer relationships within the VASP sector without a proper risk assessment.

"An effective risk-based approach will reflect the nature, diversity, and maturity of a country's VASP sector, the risk profile of the sector, the risk profile of individual VASPs operating in the sector and the legal and regulatory approach in the country, taking into account the cross-border, Internet-based nature and global reach of most VA activities.

"Just as illicit actors can abuse any institution that engages in financial activities, illicit actors can abuse VASPs engaging in VA activities, for ML, TF, sanctions evasion, fraud, and other nefarious purposes."

Studies have proven that artificial intelligence, machine learning, and Big Data are subject to bias and discrimination, plus its interconnectedness brings with it **INCREASED CONCENTRATION RISK AND VULNERABILITY** to single points of failure. Also, technological speed is no substitute for human experience, intuition, and the personal touch that is needed in managing relationships.

DIG DEEPER

Many have highlighted the use of regtech – a portmanteau of the words 'regulatory' and 'technology' covering innovations which assist financial institutions in reaching regulatory compliance – to rein in illicit behaviour. Deployment of technologies such as artificial intelligence, Big Data, cloud computing, and machine learning, has gained prominence as tighter and more complex legislative frameworks, like the Revised Markets in Financial Instruments Directive or MiFID II, come on stream.

From biometric anti-fraud measures to automated customer due diligence procedures, technology has upped the ante by optimising compliance and minimising human error. However, like every other technological tool, it is only as good as the one who wields it. Studies have proven that artificial intelligence, machine learning, and Big Data are subject to bias and discrimination, plus its interconnectedness brings with it increased concentration risk and vulnerability to single points of failure. Also, technological speed is no substitute for human experience, intuition, and the personal touch that is needed in managing relationships.

Compliance lapses merely scratch the surface of a much deeper problem. Some questions that bankers must ask themselves: Are we pushing the right reforms? Is there a missing link in our analysis? Do we have the right stuff (people as well as processes) to hold us accountable for our practices?

If the answer is 'no' to any of the above, then it's time to dig your heels in, and dig deep. ✱

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GERMANY'S ENRON: THE WIRECARD SCANDAL

Wirecard was founded in 1999 to provide a payment platform for certain, shall we say 'adult', industries. Perhaps unsurprisingly, they grew rapidly and by 2005 they had moved to a plush new head office in Munich and secured a listing on the Frankfurt stock exchange with annual revenues of circa EUR49 million.

In 2006, they completed the consolidation of Wirecard Bank AG and rebranded their corporate identity to a TecDAX listing. Wirecard Asia Pacific was established in 2007, with the same year marking the start of their issuing business, their annual revenue exceeding EUR100 million. The next five years saw further expansion in Europe coupled with significant growth in Asia Pacific and annual revenues rising to EUR395 million in 2012.

As far back as 2008, questions were being asked about Wirecard's alleged balance sheet 'irregularities' by the then head of a German shareholder association, however nothing significant transpired.

In 2010, Wirecard hired a new chief operating officer who promised global expansion, which was funded by EUR500 million of capital raised from Wirecard shareholders. Things continued until 2015 when the *Financial Times* saw fit to publish the first item in their series entitled 'House of Wirecard' which referenced 'inconsistencies' in Wirecard's group accounts.

In April 2020, things start to get interesting. An auditor for accountancy firm Ernst & Young found evidence of 'questionable accounting practices'. Fast forward to 22 June 2020 when it was revealed by Wirecard's management board that quite a lot of money was missing, their statement read "...on the basis of further examination, there is a prevailing likelihood that the bank trust account balances in the amount of EUR1.9 billion do not exist". Oops!

This revelation saw Wirecard's share value plummet by over 72% and in turn forced the resignation of CEO Markus Braun, to be replaced by James Freis, who had only joined the company the evening before. Two banks in the Philippines, that were allegedly holding the money, issued statements saying they did not have the funds and never did and to top it all, credit ratings firm Moody's removed Wirecard's rating altogether having previously demoted it to B3 from Baa3 just three days earlier. On 25 June, Wirecard filed for bankruptcy citing "over-indebtedness".

It would appear that Wirecard were also none too picky about who they chose to do business with. It transpired in 2017 that Wirecard had been processing payments for online Maltese casino CenturionBet, which was later revealed to have been used to launder money by the Calabrian 'Ndrangheta, a none too pleasant mafia-type organisation. Granted this would have represented a very small percentage of Wirecard's annual turnover, however it speaks to their business model and wider compliance function, or possibly lack thereof.

Source: *Excerpt from RDC, a Moody's Analytics company.*

STAKEHOLDERS: WHO ARE NOW THE KEY PLAYERS?

By Bob Souster

Rights and obligations must be broadened if a financially sustainable future is to be our common vision.

Most businesses now accept that to provide for a financially sustainable future they must move away from the narrow view of stakeholder obligations and towards a more inclusive model. Conventional economics suggests that profit is the return to the entrepreneurial factor of production, and in the past it has been argued by some authorities, notably Milton Friedman, that generating returns to shareholders should be the only purpose of a company. To engage in acts of social responsibility, added Friedman, amounts to a tax on shareholder wealth, as it is the shareholders themselves who should be able to make decisions on whether or not funds are committed to such purposes. If this narrow approach was even ever acceptable, it certainly no longer applies. All business organisations have to manage relationships with a wide range of stakeholders and while shareholders occupy a rightful place in their number, they are no longer the only key players, and not even the most important key players. This article explains why.

The simplest definition of a stakeholder is any party who can affect the organisation and be affected by it. Stakeholders can be individuals, legal entities, or even inanimate; for example, it is now accepted that the physical environment is a stakeholder, though its guardians can only promote its welfare by proxy. Stakeholder relationships may be viewed as sets of rights and obligations, akin to an actual, or sometimes, implied contract. Just as a shareholder has a right to a dividend if declared, the organisation has an obligation to pay it. Likewise, employees have an obligation to provide their labour just as the employer must pay a salary and provide statutory benefits.

The simplest definition of a stakeholder is any party who can affect the organisation and be affected by it. Stakeholders can be individuals, legal entities, or even inanimate; for example, it is now accepted that the **PHYSICAL ENVIRONMENT IS A STAKEHOLDER**, though its guardians can only promote its welfare by proxy.

The boards of directors of banking organisations must take their stakeholders into consideration when formulating and implementing their strategies and policies. In doing so they face multiple, and often conflicting, demands. If a bank decides to restructure its organisation to achieve greater efficiency, this may please customers, who will receive better service, and also shareholders, who are likely to see increased dividends, provided the decisions and actions are sound. However, some customers may be less impressed if they rely on branches that are to be closed, and employees may be anxious if the decision removes the need for their jobs. Put simply, it is not possible to optimise outcomes for all stakeholders simultaneously, so tough decisions sometimes need to be made on how the interests of stakeholder groups trade-off with one another. Arguably, some of these decisions are taken out of the hands of the board. If one accepts that behaviours can only be considered ethical if they are consistent with the law and regulations, prioritising stakeholders is a matter of following the famous George Orwell view (paraphrased) that 'all are equal but some are more equal than others'.

Were it ever in doubt that customers are the key players, that doubt no longer exists. The global financial crisis created anxieties that customers had somehow become short-changed by some financial institutions and their interests were subordinated to those of shareholders and executives. This is confirmed by homeowners in the USA buying houses with mortgages they could not afford and banking customers in the UK buying products that offered little or no value to them, in some cases without even knowing they had bought them.

Fortunately, Asian banks avoided these extremes, but to cement the importance of customers in the pantheon of primary stakeholders, it has been made abundantly clear by regulatory bodies, notably Bank Negara Malaysia (BNM), that customer interests should lie at the heart of everything a bank does. This was reinforced in 2019 by the 'Fair Treatment of Financial Consumers' initiative by BNM. This sets down the expectations of the regulator with regard to fair customer outcomes. It does not compel banks to operate in an error-free manner, nor does it even insist that the products and services are good, but it does expect customers to be treated fairly. Implicit in this is the requirement to minimise the risks of poor customer outcomes (conduct risk).

Such initiatives cement the place of the customer as king (or queen), something that good banks with sound governance, policies, and practices knew all along. Yet this is not an easy task. If marketing is all about finding out what customers want and providing products and services that meet their needs, the customer base of banks is becoming increasingly diverse. The traditionally favoured utilitarian approach of designing products that meet the needs of most consumers will almost certainly not address the needs of all of them. Demographic changes will also alter the dynamic: for example, increased life expectancy arising from medical advances and lifestyle changes will put more pressure on people to provide for their retirement years, especially if governments are unable to bear this financial burden through social welfare provision.

As implied above, a second key player is undoubtedly the government and public bodies charged with regulatory authority. The post-global financial crisis environment heralded a new era, moving away from so-called 'light touch' regulation in favour of more rigorous compliance regimes. These often mean that new rules are created, but it is notable that the rules are augmented by principles, not all of which can be quantified or addressed by a 'tick box' approach. A good example of this is the Malaysian Code on Corporate Governance, which includes both rules and principles. It leaves no doubt that business organisations should not only comply with the letter of the law but also its spirit. This is essential if banks are to restore the confidence and trust they once enjoyed and be regarded as good corporate citizens.

The concept of good corporate citizenship leads to an emerging candidate as a third key player among the stakeholders: the physical environment. In his groundbreaking book, *Ten Years to Midnight,* Blair Sheppard of PwC forcibly argues that the world has a mere 10 years to address the oncoming crisis arising from (inter alia) environmental disasters. Increasingly, the general public is aware of this (though not the mooted timescale), and the general public includes customers, employees, and others, yet this issue has not even been accepted as a genuine problem by some of the more controversial world leaders. It is refreshing to observe that many

> The global financial crisis created anxieties that **CUSTOMERS HAD SOMEHOW BECOME SHORT-CHANGED** by some financial institutions and their interests were subordinated to those of shareholders and executives. This is confirmed by homeowners in the USA buying houses with mortgages they could not afford and banking customers in the UK buying products that offered little or no value to them, in some cases without even knowing they had bought them.

banks have pre-empted future demands from stakeholders to conserve the environment and this is reflected in their mission, values, and objectives.

Like other major businesses, banks accept that they have an obligation to the physical environment. In pursuit of greater transparency, some are moving towards integrated reporting frameworks and away from mechanistic, mainly finance-based approaches to corporate reporting. The challenge for the future is to not only create financially sustainable business models, not easy in itself in a post-Covid-19 world, but also strategies, policies, and practices that are consistent with socially and environmentally sustainable operations. ✱

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SUSTAINABLE LENDING: THE NEW NORMAL?

By Chartered Banker Institute, UK

With both businesses and banks busy embedding environmental, social and governance practices into their activities, the post-Covid-19 world is perfectly poised for a green and inclusive recovery.

For all its shocking impact on health, society and the economy, Covid-19 represents just a taste of the havoc that the climate crisis could wreak. The Committee on Climate Change has led a chorus of calls for the UK government to make the pandemic a defining moment in the fight against global heating.

In theory, they are pushing at an open door. Businesses claim to be committed to a green recovery. More than 90% of companies surveyed by HSBC aim to re-engineer their businesses to be more sustainable.

The onus is on lenders to play their part. Corporate and commercial banks have a vital role in supporting a recovery that is not only 'green', but sustainable and inclusive. Coupled with increasing regulation, this pressure is set to accelerate the growth of lending that encourages sound sustainable practices.

PRICE AND PERFORMANCE

'Green loans' to finance defined environmental projects have been a feature of the market for some time. The term is sometimes used to encompass the relatively recent product class of sustainability-linked loans (SLLs). Both are now covered by Loan Market Association voluntary frameworks. The key difference between the two is that SLL pricing is directly linked to the borrower's performance against agreed sustainability targets.

In early financings, the borrower benefited from reduced loan margins if they met these criteria. If they fell short of their sustainability goals, the lender did not reduce the margin, but there was no additional penalty. Recently, however, two-way pricing has become more prevalent, with the borrower facing a price increase if their performance dips.

Could this lead to a perverse incentive –

in which lenders could profit from the failure of a borrower to meet its sustainability goals? Some financings have found a way around that issue – for instance, replacing the price increase with a requirement for the lender to pay into a separate account, which is then used to bolster its sustainability activity.

Some financings have found a way around that issue – for instance, **REPLACING THE PRICE INCREASE WITH A REQUIREMENT** for the lender to pay into a separate account, which is then used to bolster its sustainability activity.

SOCIETY BENEFITS

Ana Xhemalaj, one of the finalists in the Institute's Young Banker of the Year competition, notes another alternative as part of her proposal. "The lender could reinvest the penalty into their own sustainable agenda, or it could be reinvested into an appropriate third-party project or organisation, such as a charity, nominated by the client," she says. "In this way we ensure that the social angle remains the priority."

Xhemalaj notes that SLL discounts are tokens, and as such not designed to drive customer behaviour in isolation. However, she believes they are still useful: "The margin ratchet creates a window of opportunity to engage clients on their sustainability agendas when discussing some of their other, more traditional, financing needs."

In her competition paper, Xhemalaj has proposed a revolving credit facility linked to a borrower's performance on gender equity. This acknowledges the need for the SLL conversation to reflect progress in areas far beyond environmental activity, such as diversity and inclusion, and in particular the economic advancement of women. It also reflects her view that social impact should ultimately become part of mainstream lending business strategy, as well as being at the heart of measures to tackle the pandemic.

BEYOND THE BIG CORPORATES

"If we start utilising existing, well-established financing products more, we could overcome at least the initial susceptibility towards the immediate benefit to the client," Xhemalaj explains. "We also debunk the idea that we can only promote sustainability via capital market instruments, such as social bonds, or impact funds, which are often appropriate only for investors or clients already committed to the cause."

At present, she points out, material on the longer-term commercial benefits of sustainability is geared almost entirely towards large corporates. "The task really is to streamline SLLs and increase awareness among smaller companies, which are perhaps less likely to consider sustainability," Xhemalaj believes.

"I think once this knowledge gap is reduced further and we see more cross-collaboration between lenders, investors, policymakers or non-profits, we will see a lot more proactivity from clients choosing sustainability-linked facilities despite pricing differentiation," she concludes. ✱

■ *This article previously appeared in the Chartered Banker magazine, UK, Autumn 2020 edition.*

DECENTRALISATION: DOING IT RIGHT

By Dr Amanda Salter

As new work practices unfold in banks, learn to pivot quickly, but not spin out of control.

Banking has weathered the unexpected Covid-19 crisis far better than many other industries. Across all markets, from retail to investment, Asia-Pacific banks have quickly evolved ways to continue to offer critical services to customers, keeping society and economy going through the initial shock and the subsequent downturn.

One aspect of the new normal that is contributing to swifter recovery is a long overdue shift towards decentralisation in the banking operating model.

Decentralisation itself is not a new concept, and arguments (for and against) have been ongoing across the business world. In the context of a global bank, a decentralised operational structure means that decision-making takes place at a local level. Accountability, leadership, authority, and responsibility is distributed to individuals or units across multiple levels within the organisation. In other words, the person or persons closest to the customers, local regulators and the situation at hand have the control and authority to make decisions.

Findings of a 2017 joint research project by Harvard, Stanford, and MIT, titled *Turbulence, Firm Decentralization and Growth in Bad Times*, confirm that decentralisation helps firms to cope better with an economic downturn than their more centralised counterparts. The study found that firms which delegated more

decision-making responsibility to local units performed better in the years during and immediately after the global financial crisis. This suggests that effective handling of a major increase in uncertainty involves giving control to front-line managers who have a better sense of conditions on the ground than those sitting in a remote central location.

In reality, organisations usually execute a blend of both centralised and decentralised practices. In a blended model, corporate control and global regulation can still sit as a centralised function, whilst operational decisions are made by local units. There are a number of benefits that banks are experiencing from this shift. Decentralised banks enjoy higher operational resilience and flexibility, with an increased ability to respond quickly to a changing environment and emerging constraints. Increased employee motivation also results through granting of more responsibility, thus leading to higher staff retention.

Decentralisation may seem to have an obviously positive outcome, given that Asia-Pacific banks have successfully weathered the Covid storm by applying these very practices. However, some questions still remain to be addressed in this new normal. The important action for banks now is to understand the impact and implications of decentralisation, mitigate the risks, and reinforce learnings for the future.

This article explores four key areas where opportunities and risks have been introduced by the shift towards decentralised operations, together with some ways that these risks could be mitigated.

OPPORTUNITIES AND RISKS FOR TALENT MANAGEMENT

Banks should exploit the new opportunities afforded by the global talent pool and flexible remote working practices. Forward-thinking human resource leaders can take advantage of these new capabilities to push and address thorny issues such as diversity and inclusion. We are unable to go into detail here on the myriad bottom line benefits of achieving gender-diverse board representation in banking. But it's telling that in 2017, a global study of 71 banks in 20 countries by the SKEMA Business School found Singapore, China, Japan, and Hong Kong languishing at the bottom of the list in order of gender diversity of their banks. Asia-Pacific banks need to up their game here, and the widening talent pool can provide the chance to make inroads in hiring the right mix of people for your team.

On the flip side, the widening talent pool also means that your best employees can and will be targeted by a whole host of employers who you may not even have considered as competitors thus far, as they were outside your geography. A PwC report in July 2020, *Covid-19: The Impact for Global Mobility and the Mobile Workforce,* states that 43% of companies believe that the number of international remote workers will increase going forward. This is a clear risk to employee retention.

To add to this, the psychological impact of the changes and uncertainty that employees are experiencing at work and in their personal lives can lead to lower staff morale, lower productivity or motivation, or ultimately, staff resignations. There needs to be an enhanced commitment to evolving our understanding of and response to employee mental health and well-being issues. Banks need to find new ways to support, reward, and care for their employees to ensure retention stays high. Leaders need to focus on the employee experience even more than before, especially now when increasing numbers of new hires are interviewed, offered, inducted, and trained entirely remotely.

At the beginning of the crisis, the enforced digital transformation left some banks short of the right talent. This created an impetus for rapid reskilling of employees, but there is still room for improvement across the new people profiles. Banks now have the opportunity to formalise flexible pathways for reskilling and cross-train employees to move them flexibly and quickly from one role to another in response to fast-changing demand. Forward-thinking banks are also spotting the opportunity to invest in remote learning and development of their employees, especially in critical IT skills (see box story on page 32). In addition, hiring criteria may need to formally change, as employers now need individuals who are self-starters, resilient, and can collaborate and thrive in a remote working environment.

Managerial skills also need to evolve. Leaders who used to be able to 'walk the floor' may now feel increasingly disconnected from their teams. With less information on hand to help them manage performance, leaders may default to a narrower set of metrics for measuring success, which in turn may drive a decrease in employee motivation or performance.

Leading in the new normal needs

greater emphasis on soft skills such as building trust, managing expectations, and dealing with uncertainty. Leaders need to be champions of remote collaboration, and be able to lead by example in building and working with remote teams. Leaders of successful teams will be those who demonstrate trust that their team is getting the work done despite not being on the premises. Open communication, integrity, and empathy are key, and may be difficult especially when leaders themselves are under stress. Training and support may be needed in this area, along with a whole host of other skills recently discussed in the AICB's Banker of the Future webinar (see page 6).

OPPORTUNITIES AND RISKS FOR CORPORATE CULTURE AND VALUES

Regulators are looking to hold banks and their leaders to account for the conduct and culture in their firm. A strong corporate culture is a must-have to keep a distributed workforce resilient and to support good decision-making, especially in difficult times. However, banks may need new tactics to build and maintain core corporate culture and values, and this may not be straightforward in the context of decentralised hiring and remote working. *Insight*, the UK Financial Conduct Authority's (FCA) publication to help financial markets work effectively, highlights the increased risk of misconduct when employees are working unobserved, including the lack of ethical cues from colleagues and a perception of reduced personal accountability.

To combat this, banks need to create a healthy workplace culture and drive the right behaviours. The FCA describes four drivers of culture: purpose, leadership, governance, and the approach to reward and managing people. The way that banks reinforce culture across each of these four drivers may need to change and adapt to build a strong culture across a distributed workforce.

Managers and leaders play a major role in building and disseminating core culture and values. They should clearly communicate purpose and vision in a way that motivates people, unites distributed teams, and provides stability and direction. New ways should be created to empower the workforce to raise any concerns. Leaders should visibly demonstrate that they hold every individual accountable for their own behaviour, even in a remote workplace, and it is necessary to put new practices in place to remain close to the work that is happening and the team members carrying it out.

OPPORTUNITIES AND RISKS FOR TREASURY AND RESOLVABILITY

Having dealt with the immediate need to manage liquidity post-Covid, the opportunity is ripe for banks to look at transforming treasury functions strategically for the longer term. Rapid policy and regulatory changes have reinforced the credibility of a decentralised or at least 'centrally decentralised' treasury model. Such models empower local management, giving them control over cash operations with support from regional bases, whilst corporate control and group-wide reporting responsibilities rest centrally.

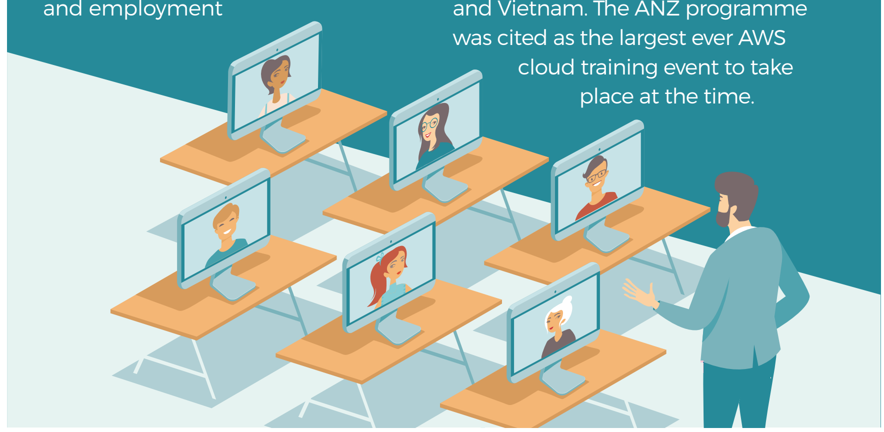
To support a decentralised treasury model, and also the decentralised teams who manage it, there is a pressing need for a real-time, virtual, predictive, global view of the cash position across all country units. Such a system must be accessible anywhere, anytime, and take into account local regulations, tax, and compliance issues.

Forward-thinking banks are already exploring new technologies to support not only their own but their clients' treasury needs with new methods of data connectivity, from cloud-based platforms to data sharing via APIs (application programming interfaces). Treasurers need to expand their traditional toolkit to include skills in new proposition development and digital technology for a more effective global treasury.

There are, of course, corresponding risks involved when considering this level of transformation to such a key function within a bank. Strong governance, as always, is needed to ensure risks are managed and mitigated. A central governance team should still be responsible for control and reporting at a global corporate level. There must be thorough reviews of new policies with processes, training, and resources

One example of rapid technological reskilling of the workforce was masterfully executed at ANZ. In May 2020, the bank put together an accelerated programme enabling their employees to become certified Associate Cloud Practitioners for Amazon Web Services (AWS) in just one week. The bank would pay for a practice run and the final exam if employees met attendance and employment requirements. The training materials and channels were well prepared, with an off-network self-service website that could be accessed on personal devices.

The training attracted 2,000 employees, with more than 100 people eventually earning certification. Participants included staff from Australia, India, New Zealand, China, Singapore, the Philippines, Indonesia, and Vietnam. The ANZ programme was cited as the largest ever AWS cloud training event to take place at the time.



in place. Any new technology must be rigorously and aggressively tested before it can be made fully operational. As the solution needs to span multiple countries, it's critical that local country units are consulted and involved throughout to ensure their individual needs are understood and met.

A successful solution in this space would also go far towards fulfilling the regulator's requirements to demonstrate resolvability. However, the challenge and associated risk of having to deal with multiple legal entities, multiple decision makers and a higher degree of complexity in terms of distributed governance will still remain.

A successful solution in this space would also go far towards fulfilling the regulator's requirements to demonstrate resolvability. However, the challenge and associated risk of having to deal with multiple legal entities, multiple decision makers and a **HIGHER DEGREE OF COMPLEXITY** in terms of distributed governance will still remain.

IMPLICATIONS AND RISKS FOR DECISION RIGHTS

To conclude, we must address the general concept of the decentralised model, namely, that decisions are made by autonomous local units. Empowering frontliners in this way helps to achieve quicker turnarounds, maximising the bank's ability to respond and react to change in timely fashion, but the risks here are no less significant. When decisions are spread across multiple units in different locations, if these are not controlled and communicated correctly, the wrong decisions could be made and remain undiscovered until it's too late. Some decisions with no clear ownership could also fall through the cracks.

To mitigate this, banks should aim to capture and clearly communicate decision rights to everyone concerned. This entails clearly and formally granting autonomy and discretionary power to the correct individuals and units, at the right levels, and then ensuring everyone knows exactly who is responsible for making the decision. All decisions should be fully traceable, with remote sign-off processes in place.

Leaders also need to ensure that employees are empowered to raise concerns or challenge any decisions that are made at speed as unforeseen circumstances are likely to arise. It is crucial for to create safe spaces for employees to raise challenges without fear of punishment.

Central functions such as risk management, policies and standards, methods and audit still need to be maintained in an optimal blend of decentralised-centralised models. All central functions need to remain strong and not defer to local units, no matter how profitable or powerful the local units are.

Despite the risks, it's clear that the disruption of finance via next-generation operational models built on the principles of shared governance and devolution of power will continue.

As banks reap the benefits of an increasingly decentralised operating model achieved within an accelerated timeframe, what remains now is to identify and mitigate the emerging risks posed by these changes, and lock in wins for the long term. ✱

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CATALYSING BANKABLE NATURE SOLUTIONS THROUGH BLENDED FINANCE AND BUSINESS MODEL INNOVATION

By World Wide Fund for Nature

The monetary value of nature is estimated to be around US$125 trillion in which half of the world's GDP amounting to US$44 trillion is highly dependent on it and potentially exposed to risk from nature loss. Around 1.2 billion jobs in the nature-related sectors such as farming, fisheries, forestry, and tourism are dependent on the effective management and sustainability of healthy ecosystems.

However, climate risks and biodiversity loss are becoming more significant in the age of the Anthropocene, evidenced by the growing economic and financial losses impacting businesses, financial institutions, governments, and society. In Malaysia alone, more than 50 natural disasters in the past 20 years have resulted in over RM8 billion losses with more than 3 million people affected through displacements, injuries, and death. Businesses such as Pacific Gas & Electric, a public utility company with US$20 billion market capitalisation in the US, filed for bankruptcy in 2019 due to lawsuit cases by the victim of wildfires sparked by one of its facilities. The non-performing loan ratio of representative coal-fired power companies is estimated to exceed 20% by 2030 due to a decline in demand and a drop in clean energy costs.

There is an investment gap of US$2.5 trillion every year to achieve the Sustainable Development Goals by 2030. For preserving and restoring ecosystems alone, only US$52 billion is being invested out of US$300 billion to US$400 billion that is required. Public funds alone are insufficient to fill this gap. This is aggravated by the perception of the private sector that nature conservation projects are relatively unattractive due to low financial return.

Bankable Nature Solutions (BNS) might be an answer to this quest as it promotes nature conservation and offers a comparative financial return. BNS can be understood through three dimensions namely (1) environmental and social sustainability, (2) business viability, and (3) fundability. First, BNS aims to reduce negative pressure on ecosystems, drive resilience and sustainability for humans and nature. Second, BNS seeks to generate positive returns for communities, businesses, and investors. Third, through blended finance, BNS creates an enabling environment for private investors and catapults public and philanthropic funds towards a financially self-sustaining approach.

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BNS PROJECT CASE STUDIES

There is a growing number of business and investment opportunities associated with maintaining, preserving, and restoring nature through structured, blended, and project finance. A global survey of 168 financial institutions, asset owners, and asset managers demonstrates that investment in natural capital could reduce risk, boost the resilience of investment portfolios and enhance their reputation. The following highlights the financial structure and positive impact of two BNS projects in Turkey and Greece.

The Buyuk Menderes River Basin project in Turkey (**Diagram 1**) aims to improve the water quality in the river basin to ensure clean water supply for the community. The project supports the textile company in adopting a cleaner production process that uses less water, chemicals, and energy and reduces solid waste and waste water. It is made possible from a combination of (1) grants to undertake feasibility studies, (2) loan from local banks to finance the cleaner production methods (EUR5 million to EUR12 million with six-months to two-years payback period), and (3) commitment from fashion brands to buy from manufacturers which fulfill the Higg index. As a result, there were savings from EUR4 million to EUR12 million annually, saving 1.5 million cubic meters of water and mitigating at least 20% negative impact on water quality.

Another insightful example is the green infrastructure for the urban resilience project in Athens. The municipality of Athens received a EUR5 million loan from Natural Capital Financing Facility (NCFF) to enhance the resilience of the city against climate change impact by reducing urban temperature, mitigating urban heat island, and increasing water infiltration as outlined in the Athens Resilience Strategy for 2030. The financing facility is accompanied by a technical assistance grant amounting to EUR500,000 to redesign urban spaces in Athens, including the restoration of parks, public squares, streets, revitalisation of Lycabettus hill, among others.

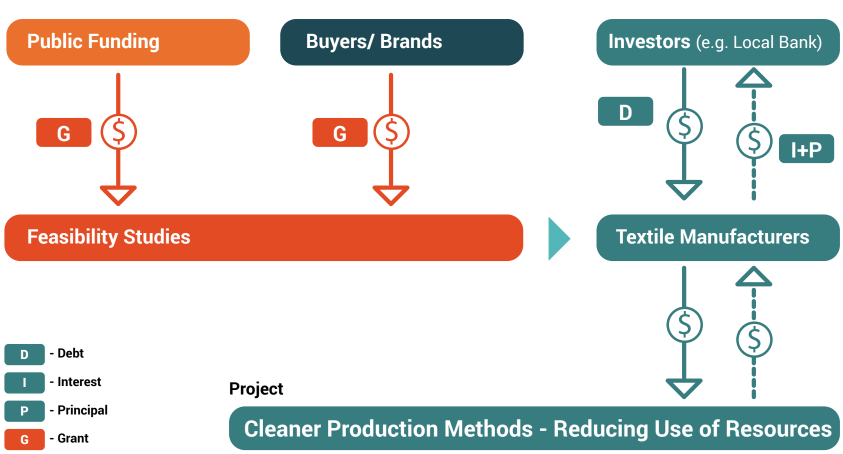


Diagram 1: Financing structure of Buyuk Menderes River Basin project
Sources: Adopted from the Blueprint for Bankable Nature Solution by the WWF Netherland

FUNDING FACILITIES CASE STUDIES

There have been a number of funding facilities around the globe to facilitate bankable nature projects. The NFCC is a partnership programme between the European Investment Bank and the European Commission to facilitate conservation and nature-based solution projects. This is structured through a flexible financing facility (debt and equity funds between EUR2 million and EUR15 million backed by an EU guarantee) and technical assistance (including a grant up to EUR1 million) to support sustainable projects. Several funding facilities are supported by the NCFF such as the Irish Sustainable Fund (EUR12.5 million) on sustainable forestry and

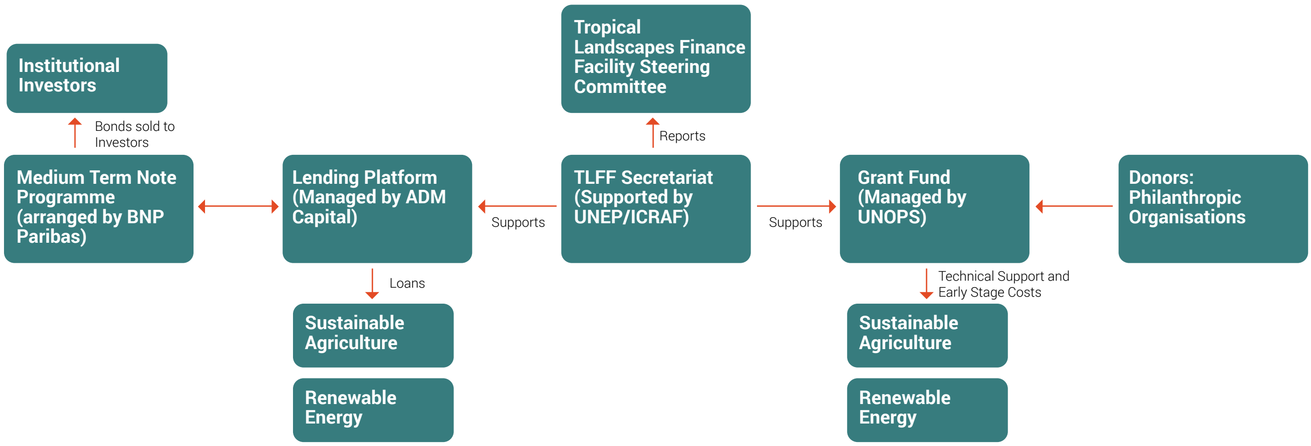


Diagram 2: Financing structure of TLFF
Sources: Adapted from Tropical Landscapes Financing Facility

Rewilding Europe Capital (EUR6 million) in supporting nature-focused business in Europe.

The Tropical Landscapes Financing Facility (TLFF) (**Diagram 2**) in Indonesia is the first private landscape financing initiative by the government of Indonesia supported by the UN Environment Programme, World Agroforestry Centre, ADM Capital, and BNP Paribas. The initiative was launched in 2016 leveraging public funding to mobilise private finance for projects that foster green growth (biodiversity, forest management, ecosystem restoration, and renewable energy projects) and enhance rural livelihoods. TLFF have two funding channels, namely a lending platform and a grant fund. The lending platform offers a long-term loan which could be securitised through the medium-term note programme, while the grant fund provides technical assistance and co-funds early-stage development costs.

POTENTIAL OF BNS IN MALAYSIA

One of the BNS projects that has been developed in Malaysia is the Acacia Forest Industries (AFI) project in Sabah funded by Tropical Asia Forest Fund (**Diagram 3**) through close-ended private equity. The project aims to introduce sustainable forestry management practices and make AFI a major certified eucalyptus producer in the region. The project created positive impact on the landscape, including 2.5 million seedlings planting per year, 25,000ha area planted with timbers, and half the area allocated for conservation and livelihood improvement. Cash flow is generated from the sales of mature Forest Stewardship Council (FSC) certified timber at a premium price, sales of latex, and carbon revenue.

Given Malaysia's biodiversity, climate, and livelihood conditions, there are several potential projects that can be catalysed into BNS. For example,

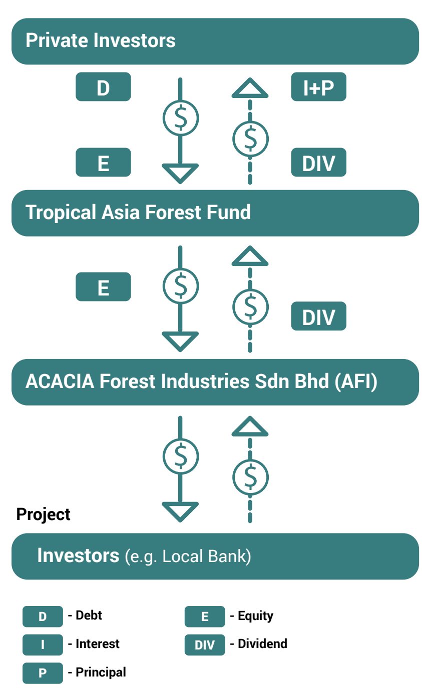


Diagram 3: Financing structure of AFI Project
Sources: Adopted from the Blueprint report for Bankable Nature Solutions by the WWF Netherland

the Kedah Sustainable Landscape Initiative (KSLI). Comprising eight forest reserves, the Ulu Muda Forest Complex (approximately 164,000ha) is a vital water catchment forests for three northern Peninsular states of Kedah, Penang, and Perlis, providing water provisioning services to more than four million people, enabling economic development, and contributing to the nation's food security. KSLI is an integrated landscape approach that looks beyond the scope of a single sector stakeholder group and looks at the scale of a land management unit to meet the needs of diverse stakeholders and sectors. Among the activities of the projects include:

- Establish a protected areas system and framework in Kedah to protect biodiversity and vital ecosystem services;
- Forest restoration and certified management for the purposes of rehabilitating vital ecosystem services and to ensure ecological connectivity to the Central Forest Spine;
- Establish a high-end tourism operation that models circular economy, regenerative practices, supports biodiversity research, and provides a sustainable livelihood to the local community; and
- Adoption of sustainable practices in paddy farming.

In the Baleh watershed, an integrated watershed management (IWM) approach is being advocated as a pilot project in Sarawak. The project aims to improve watershed management and governance which will result in increased protection of water catchment forests for water supply, rivers and its freshwater ecosystems, secure habitats for wildlife, improve water quality for communities and protect economic investments. A Baleh Wildlife Connectivity area is located within this watershed, connecting key national parks within Sarawak to the large national parks of Betung Kerihun and Kayan Mentarang in Kalimantan, Indonesia.

The project will involve joint efforts from government agencies and private sector to build capacity on IWM, to improve ecological and environmental information that will help in more informed decision-making, and establishing alternative financial support for areas set aside for water and species protection. There is also a large hydropower project to be constructed in the area. WWF-Malaysia provides the lead technical support, convening multi-stakeholders, capacity building on IWM, work with communities for the river, fish, and livelihood protection, respective studies for environmental and alternative finance potential for protected areas.

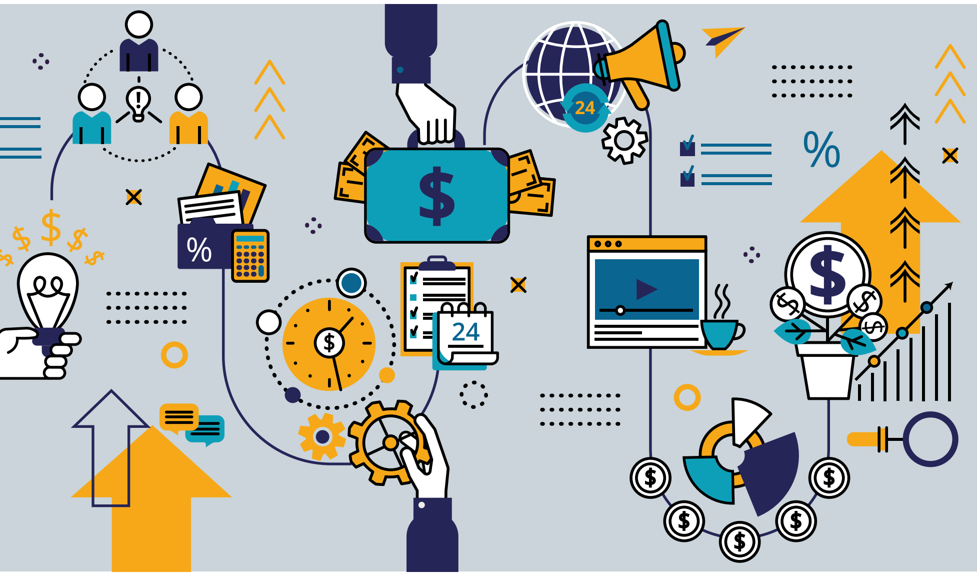
A centralised platform also allows better ideas and information exchange which is **CRUCIAL TO ACCELERATE SUSTAINABILITY** and facilitate innovation in business and conservation programmes. Resource sharing to facilitate innovation in the business and conservation programmes could help businesses better account for their impact and dependencies on biodiversity and natural capital.

CONCLUSION

Participation of stakeholders from banks, investors, civil societies, and the government is crucial in moving forward the climate and nature-based solution in Malaysia:

- **Funders**

Funders may support BNS projects through different financing schemes. Among them are traditional loan, result-based payments financing (e.g. The Livelihoods Investment Fund in Sustainable agroforestry dairy project in Mount Elgon, Kenya), sustainability bond (e.g. bond for TLFF-PT RLU project arranged by BNP Paribas), blended finance (e.g. As-Samra waste water treatment plant financing led by Arab Bank together with public funding from the United States Agency for International Development, Millennium Challenge Corporation, and the Jordanian government), and soft loan



with an interest rate below market return (e.g Fairventures Social Forestry project in Indonesia).

In tapping into BNS, the funders may leverage the growing technology and dynamic tools that can gather data and evaluate the impacts of the projects. Satellite imagery and remote sensing data can monitor environmental indicators such as forest cover changes. For instance, the Global Forest Watch Pro tool is used by Inter-American Development Bank in Paraguay to detect deforestation.

There are also numerous opportunities in BNS by supporting the net zero-emission goals of the corporations. Locally, Petronas is the first oil company in Asia aiming to be carbon neutral by 2050. One of its strategies is to invest in nature-based solutions that preserve and restore the capacity of ecosystems to act as forest-based carbon sinks for CO_2 sequestration. There is an opportunity for collaboration in projects that support key conservation measures such as reforestation, community empowerment, and co-management.

- **Business-Funder Platforms**

The lack of centralised platforms to stimulate and match businesses and funders may stunt the growth of sustainability ventures. Efforts should be initiated by intermediaries such as business associations/business chambers to establish credible online platforms that connect sustainable buyers, suppliers, and funders. To accelerate the transition, sustainability standard owners from different industries (such as B corporation, Roundtable on Sustainable Palm Oil, Forest Stewardship Council, Programme for the Endorsement of Forest Certification, Aquaculture Stewardship Council, etc) could be included to facilitate direct consultations and technical advice. Such a platform could be a channel for sustainability-based producers to secure offtake from big brands and allow big brands to address their traceability issues in maintaining their sustainable value chain. The offtake mechanism also enhances the financing options for sustainable projects.

A centralised platform also allows better ideas and information exchange which is crucial to accelerate sustainability and facilitate innovation in business and conservation programmes. Resource sharing to facilitate innovation in the business and conservation programmes could help businesses better account for their impact and dependencies on biodiversity and natural capital.

- **The Government**

Through innovative arrangements with multilateral financial institutions, the government can seek technical assistance funds to support the generation of ideas and co-fund early-stage development costs. For instance, the government of Indonesia and the Global Green Growth Institute's (GGGI) Green Growth Program helps to develop and enable bankable projects. GGGI serves as the facilitator in bringing together various relevant stakeholders, including the government, international and national investors, and project developers to stimulate green capital flows.

Apart from multilateral financial institutions, UN agencies such as Food and Agriculture Organization support countries with tools and technical assistance to establish innovative and inclusive domestic finance mechanisms for Reducing Emissions from Deforestation and Forest Degradation (REDD+) and land-use investments. Environmental fiscal transfers provide financial support such as tax deduction for green projects and investment to attract investors and funders (e.g. tax deduction on socially responsible investment sukuk in Malaysia) and first-loss guarantee scheme for bankable green projects should also be replicated and scaled up. ✱

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THE QUANDARY OF DIGITAL PAYMENTS

By Dr Eli Remolona

WHEN IT COMES TO DIGITAL PAYMENTS, THE NEAR FUTURE IS NOT SO HARD TO PREDICT.

With the advent of private digital payments, central banks around the world are finding themselves in a quandary. Their role in the payments system, after all, is one of their core functions, along with monetary policy and banking supervision. The quandary is about how to take advantage of the new technologies to foster payments efficiency, while maintaining the integrity of the system.

ROOTS OF MODERN PAYMENTS

Our modern payments system has its roots in 17th century London. It was there that wealthy merchants started to store their gold with goldsmiths. Soon the goldsmiths began to issue promissory notes backed by the gold in their vaults. These notes became so widely accepted as a means of payment that the full backing of gold became unnecessary.

By the Restoration period in England, the goldsmiths had organised an unregulated system

of fractional reserve banking and a payments system based on reciprocal note acceptance and interbank clearing. The goldsmiths would accept each other's notes and keep well identified accounts for one another. As the story goes, these goldsmith-bankers would gather at the Five Bells Tavern on Lombard Street to exchange cheques and debit or credit each other's account. This was the birth of what we now call the account-based payments system, one that requires the identification of the two parties to each transaction.

In 1694, the Bank of England was granted a royal charter to serve as banker to the crown. Even as a private bank, it would issue handwritten banknotes that became widely accepted as money. Until the 19th century, however, it did not have a monopoly of note issuance in England, and notes issued by provincial banks also circulated widely. A semblance of monopoly over fiat money was secured with the Bank Notes Act of 1833, which conferred 'legal tender' status on the Bank of England's banknotes. This part of the system is what we now call the token-based payments system, one that requires no accounts in the names of the parties involved.

From those beginnings, the payments system has evolved into one where a token-based system operates side by side with an account-based system.

THE RISE OF THE ACCOUNTS

In 2009, Paul Volcker, the former Fed chairman, famously said, "The most important financial innovation that I have seen in the past 20 years is the automatic teller machine (ATM)…". While Mr Volcker may have been exaggerating, the innovation he identified is about the payments system. The ATM is a technology that links the account-based system to the token-based system.

For most of the past 300 years, it is the payments technology of the Five Bells Tavern that has proved to be more innovative. The innovations have led the account-based systems to branch out into two parts, a retail part and a wholesale part.

In the wholesale part, we now have

systems that process large-value payments in real time. The grandaddy of these systems is Fedwire, a real-time gross settlement (RTGS) system that was launched by the US Federal Reserve in 1970. The United Kingdom followed in 1984 with an RTGS system called CHAPS, and France in the same year with a system called SAGITTAIRE. By 2005, about 90 central banks were operating RTGS systems, including CNAPS in China, RENTAS in Malaysia, PhilPaSS in the Philippines and BAHTNET in Thailand.

In the case of Fedwire, in August 2020, the RTGS system processed over US$3 trillion a day in final and irrevocable payments. By and large, these real-time payments are used for large securities transactions, allowing delivery versus payment across accounts at the Fed. There are over 7,000 well-verified accounts. In case of disruption, the Fed stands ready to provide backup liquidity.

In the retail part, modern payments rely on three links of a payments chain. The diagram below depicts these three links by using the example of China's retail payments system. The link at one end of the chain is that of intermediaries, which are typically banks. These intermediaries move funds between consumer and merchant accounts and among themselves by means of interbank clearing mechanisms, including a cheque-clearing system, a shared ATM network system, and an electronic transfers system. The next link in the chain is that of payment service providers (PSPs), which serve to authorise payments and also maintain some accounts of merchants and consumers. At the level of consumers and merchants, various forms of electronic technologies communicate with the PSPs to allow the transactions to go through.

IN RETAIL PAYMENTS, TWO TECHNOLOGIES ARE FIGHTING FOR DOMINANCE

The dominant way to communicate with PSPs used to be a magnetic strip on the back of your credit card. That has now given way to two competing technologies: near-field communication (NFC) and the QR code. Credit card payments now rely largely on the NFC technology, which allows payment by waving a card near the merchant's device. In this case, communication with the PSP works through the merchant's device. In China, the dominant PSPs are Alipay and WeChat Pay. They rely on the QR code technology, in which communication with the PSP works through the consumer's smart phone. According to Aaron Klein's article, *Is China's new payments system the future?*, published by Brookings Institution, China's experience suggests that the QR code technology is far more efficient than the NFC technology.

THE REVENGE OF THE TOKENS

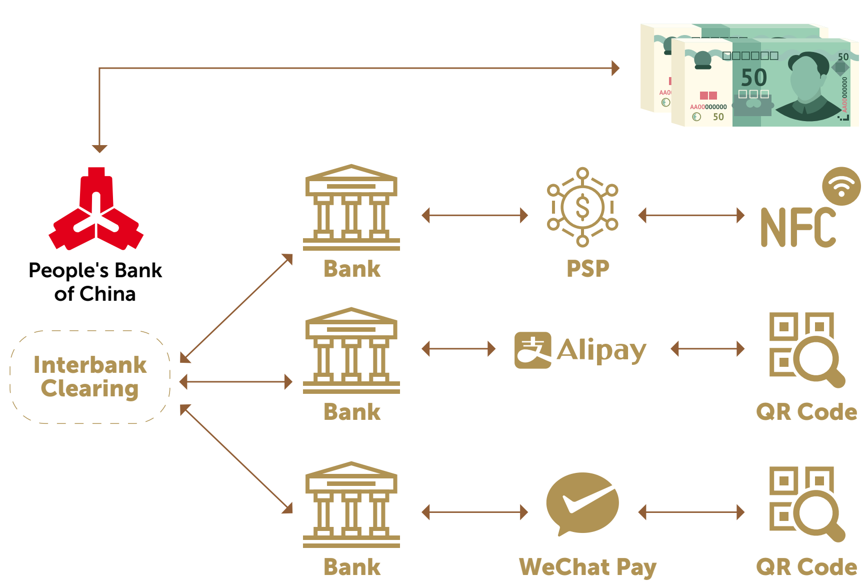
Distributed ledger technology (DLT) burst upon the payments scene in 2009. That was when the DLT-enabled cryptocurrency, Bitcoin, came into existence. Cryptocurrencies are digital tokens that, like banknotes, can be transferred from peer to peer without the need for accounts at intermediaries.

The introduction of Bitcoin was followed by other cryptocurrencies – Ethereum, XRP, and Tether. As of April 2020, the combined value of cryptocurrencies is estimated at US$128 billion. That is a puny amount compared with the world's money supply. The US money supply in the form of M2 is already about US$19 trillion. On the whole, cryptocurrencies have not lived up to their hype.

The experience of Bitcoin and other permissionless cryptocurrencies has revealed two problems that make these digital tokens particularly troublesome as a means of payment. First, they are unreliable as stores of value, behaving more like speculative investments than bank deposits. Second, they are excruciatingly slow. Bitcoin's block size limit and proof-of-work verification process reportedly allows at best only seven payments per second. Visa, by contrast, is able to process 24,000 payments per second.

The more credible challenge to the modern payments system has come from private stablecoins. These are cryptocurrencies that are designed to address the volatility of the earlier generation. Tether, for example, is a stablecoin that pegs its value to the value of a national currency, such as the US dollar.

In June 2019, the announcement of a proposed new stablecoin forced central banks to take serious notice. The announcement was that of Libra, a global stablecoin proposed by Facebook along with an "Association" of other companies. To avoid volatility, Libra would be backed by a basket of reserve currencies. To avoid long processing times, it would initially be a 'permissioned blockchain' in which verification would be left to the members of the Libra Association. In April 2020, after various



regulators expressed some concerns, the Association released a Libra 2.0 white paper. The revised plan promised to offer single-currency coins within a robust compliance framework and to remain a permissioned blockchain.

TO CBDC OR NOT TO CBDC

Seeing themselves as the custodians of the payments system, central banks have not been sitting still.

The low-hanging fruit has been to upgrade the existing interbank clearing systems. In 2018, the Eurosystem launched the TARGET Instant Payment Settlement (TIPS) service, which provides payments in real time around the clock. Not to be outdone, the US Federal Reserve has been developing FedNow, a service that will similarly allow financial institutions to offer instant payments around the clock.

For many central banks, however, the most important response to cryptocurrencies has been to try to create their own central bank digital currencies (CBDCs). For the central banks, it is a process of learning by doing in a world of fast-changing technology.

+ In regulating the payments system and undertaking their CBDC projects, central banks have been trying to adhere to several design principles. These principles include the following:

The government should provide the foundational architecture;

The different payment systems in the economy should be interoperable;

The CBDC should be efficient, secure, and stable in value;

It should strike a balance between privacy and the need to 'know your customer'; and

It should not serve to disintermediate the banking system.

The CBDC projects themselves vary in their objectives, some focusing on retail payments and others on wholesale payments. The projects that are furthest along are those of China and Sweden. Both China's e-CNY and Sweden's e-krona are now in the live testing stage.

CENTRAL BANKS	PROJECT	STATUS	INTENDED USE
Canada	Project Jasper	Pilot	Wholesale
China	DCEP or e-CNY	Live testing	Retail and wholesale
Euro area and Japan	Project Stella	Pilot	Wholesale
Hong Kong and Thailand	Inthanon-LionRock	Pilot	Wholesale
Singapore	Project Ubin	Pilot	Wholesale
Sweden	e-krona	Live testing	Retail

Chart 1: Many central banks have a CBDC in the works
Sources: *After Libra, digital yuan and Covid-19: Central bank digital currencies and the new world of money and payment systems* by Douglas Arner, Ross Buckley, Dirk Zetzsche, and Anton Didenko, EBI Working Paper Series 2020 No 65; Inthanon-LionRock Report.

The People's Bank of China is testing a token-based DLT with account-based elements. The use of CBDC tokens will be limited to top-tier intermediaries, which will be able to settle payments with finality through the central bank's accounts. China is also seeking to force Alipay and WeChat Pay to make their systems interoperable.

For its part, the Swedish Riksbank is testing both an account-based and a token-based CBDC. Both will provide instant payments. However, the account-based e-krona may earn interest and will be traceable, while the token-based e-krona will allow anonymity and will not be traceable if it is prepaid.

An interesting project that is still in the pilot stage is a collaboration between the Hong Kong Monetary Authority and the Bank of Thailand. The project is called Inthanon-LionRock, named after mountain peaks in Thailand and Hong Kong. The objective is to transform cross-border wholesale payments, a system that has long suffered from inefficiency and settlement risk. The proposed new system will finally allow real-time cross-currency transfers with payment-versus-payment settlement.

THE FORSEEABLE FUTURE

Yogi Berra, the American baseball player, said, "It's tough to make predictions, especially about the future." When it comes to digital payments, however, the near future is not so hard to predict. It is safe enough to say that we will see three futures in the next few years:

+ First, central banks will soon operate enhanced interbank clearing systems that will allow real-time round-the-clock payments. The European Central Bank, Bank of Korea, and Banco de Mexico are already doing so.
+ Second, central banks will offer both account-based and token-based CBDCs. The People's Bank of China and the Swedish Riksbank are well on their way to doing so.
+ Third, a Libra stablecoin that complies with regulatory standards will be launched globally in the next year or so.

What an exciting time for payments! ✱

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WHEN OPEN BANKING BECOMES A REALITY

By Ng Hui Chen & Prof Dr Nafis Alam

Institutions should relook legacy business models.

Banks are getting transformed from branch-based banking to a digitally focused service provider driven by a low-cost, efficient and rich customer experience. Openness and collaboration amongst the banks have emerged as a new normal for the banking sector. The Covid-19 pandemic has further accelerated the digitalisation move and shifted the consumers' perception in adopting technology in their daily life. Open Banking, a term that was viewed as 'hype' a few years ago, has now become a reality.

WHAT IS OPEN BANKING AND ITS CURRENT STATUS?

Customer data are often treated as a highly confidential assets of the banking industry, partly attributed to regulatory requirements such as the Personal Data Protection Act and banking secrecy laws. However, this 'closed' banking model has caused inefficiencies and unsatisfactory banking experience for the consumers as they often fail to have a unified view of their financial position. The banking model needs to be adapted to deliver value and satisfy customers' experience in the era of digitalisation.

As a result of this, the concept of Open Banking was coined. It is a mechanism that allows banks to share the financial data of their customers with the third party through application programming interfaces (APIs). This data sharing inititives has given rise to new channels for payments and wealth management services. Customers can now aggregate their financial accounts into one platform to better manage their financial transactions. Small payments can be made seamlessly between accounts at different banks.

Open Banking gained traction even before Covid-19 pandemic spread across the globe. The Financial Brand in early 2020 reported that as much as 87% of


BANK

countries were offering Open Banking in some form or other, while the Open Bank Project reports that 47 countries around the world have or are considering adopting open banking policies. If we focus on individual nations, in South Korea, the regulator reported that 20 million people are using Open Banking services as at July 2020, a service which was only launched only in December 2019. The Open Banking Implementation Entity, the entity established by the Competition and Markets Authority to drive Open Banking in the UK announced in September 2020 that users of Open Banking enabled products surpassed the 2 million mark, doubling in just over six months. The conventional payment card association, Mastercard launched its Open Banking platform to facilitate Open Banking initiatives in June 2019. In June 2020, Mastercard further accelerated its Open Banking move by acquiring real-time financial data aggregation service firm, Finicity. In Europe, the regulatory standards, the revised Payment Services Directive (PSD2) and General Data Protection Regulation are driving Europe in adopting Open Banking standards. The US is also experimenting with open banking but the progress is slow as American consumers have a lot of data privacy concerns which can be a sensitive topic, among older consumers.

When it comes to the Asia Pacific region, there is a big push for Open Banking. In fact, a recent survey by Finastra revealed that close to 100% of financial institutions in Singapore and Hong Kong think Open Banking is important, with two-thirds in Singapore calling it a "must-have". If we focus on Malaysia, the central bank Bank Negara Malaysia published a policy document to set out the requirement for open API for open data by financial institutions on 2 January 2019. The policy document encourages financial institutions to adopt the Open Data API Specifications on selected product information developed by the Open API Implementation Groups. The growing digitalisation trend, changing customers' perception coupled with the regulator's support, open banking is all set to transform the banking industry in Malaysia.

WHAT ARE THE OPPORTUNITIES AND RISKS?

While some banks may not seem to be in favour of open banking, open banking will bring strategic advantages to the banks.

By connecting with other APIs, banks will be able to receive additional customer information. This information will help banks to expand their offerings and offer more personalised services to their customers through a better understanding of customer behaviour. Besides, banks can also make better lending decisions as they can perform better credit evaluation with additional information. At the same times, banks can venture into underserved markets such as peer-to-peer lending, etc.

However, all those benefits come with some risks as well. The security issue is one of the greatest challenges in Open Banking adoption. Open Banking platforms, the custodian of customer data, are the popular target of hackers. Risks associated with data privacy, data loss, identity fraud are always the concern of Open Banking adoption. When there are data breaches, accountability and ownership become the issues. The parties that should take the blame or responsibility of the hacking become less clear as the data are shared across the platform.

Data sharing will emerge as the biggest roadblock in realising the full potential of the Open Banking concept. Banks may be sceptical in sharing data with rival banks, hence they could find ways and means to delay sharing/opening up the data. Data privacy issues will also be a concern for customers when they are dealing with unregulated start-ups who might be involved in sharing or selling the data with their partners and thereby misusing customer data, without consent of the customer.

Apart from that, Open Banking will also present strategic risks to the banks. Banks must deploy an appropriate strategy to tap into the new opportunities from Open Banking and find the right partners to develop the platform.

ROLE OF REGULATORS

The success of Open Banking not only lies with banks and start-ups but banking

regulators also have to play an important role. The biggest challenge for the success of Open Banking is data sharing and data privacy and the regulator has to put proper checks and controls in place to regulate the whole initiative.

The regulators need to make sure that sensitive customer information is not shared. It is of utmost importance that regulators set up guidelines and inform all parties about what information can be shared and what would remain confidential to the bank. If the proper checks and controls are not put in place, Open Banking can lead to increased financial fraud and even unauthorised money transfers leading to money-laundering incidences. To protect customers, the regulators have to bring in stringent policies to penalie the parties involved, which can be a bank or an intermediary, if there is any data breach.

There has been some progress towards open banking regulations. A revised PSD2 applicable to banks and digital money providers can further facilitate access for third parties to both transactional data and payment operations. Banks can choose whether to develop APIs which, although not standardised, must be approved by

the regulators. While in Singapore, the Monetary Authority of Singapore published an API Playbook to encourage banks to open up their systems and services in an innovative way.

WHAT THE FUTURE HOLDS?

+ We will see once Open Banking is implementd successfully across the region, potential changes to the business model as follow:

Banking-as-a-Service model: Banks will move from one-stop centre to financial platform. Banking services will be unbundled into modular based services.

Product specialists: As banking services are expected to be unbundled, banks will slowly be specialised in their niche areas with core products.

Infrastructure giants: Some companies will become back-end infrastructure providers to the banking industry, such as API providers, cloud providers, etc.

Front-end providers: Some companies will start to build an aggregated platform for customers for access to different banking, fintech, and other services. For instance, on 8 October 2020, AirAsia revealed its super app which aggregates travel, e-commerce and fintech services.

The regulators need to make sure that sensitive customer information is not shared. It is of utmost importance that **REGULATORS SET UP GUIDELINES AND INFORM ALL PARTIES** about what information can be shared and what would remain confidential to the bank.

Even though it's a long way ahead for Open Banking to become mainstream, incumbent banks must look at their legacy business model as a service provider or to transform themselves as a platform-based ecosystem where the customer will be the king and customer data will be the new gold. Regulators have an important role to play to make sure that Open Banking remain open to the right provider and the right users. The silver lining is that 80% of the bankers feel that Open Banking is not a threat to them and they are looking forward to using this as an opportunity to increase their market share. ✱

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THE CRUNCH AIN'T EQUAL

WHEN PANDEMIC, SOCIAL JUSTICE & FINANCE COLLIDE

By Kannan Agarwal

IN THE THROES OF THE DEEPEST GLOBAL RECESSION SINCE WWII, INCLUSIVE FINANCE MUST BE THE CORNERSTONE TO OUR RECOVERY.

Some have called this pandemic The Great Equaliser. Others think otherwise.

Since the outbreak, the World Economic Forum reports that the combined wealth of US billionaires increased by over US$637 billion to US$3.6 trillion.

Top of the pops is Jeff Bezos, whose personal net worth jumped a whopping 63% during the pandemic and is now worth US$184 billion. In October, Bezos' digital behemoth Amazon announced a record third-quarter profit of US$6.3 billion with plans to expand its physical fulfilment centres to keep pace with demand. Others on the list include Eric Yuan (Zoom), Mark Zuckerberg (Facebook), Steve Ballmer (Microsoft), and Elon Musk (Tesla and SpaceX).

Then we have the bottom of the pyramid – 81% or 3.3 billion citizens who have had their workplace fully or partially closed according to the International Labour Organization (ILO).

This isn't about disenfranchisement, an ever-present spectre in every recession. This crisis is different from others as it's resulted in a windfall for the ultra-rich, the 1%, with no existing redistribution effect for the rest of the 99%.

Digital companies like Amazon, Google, Facebook – which benefited the most from the fallout – have paid zero or negligible levels of income tax for years. Amazon's 2017 and 2018 tax filings with the US Securities and Exchange Commission show US$0 and hundreds of millions dollars in tax rebates the company received from the government.

After intense backlash from the media and citizens, this year, it declared US$162 million in taxes for 2019. The news was greeted with acerbic headlines – 'Amazon finally owes federal income taxes this year' by *The Verge* media and 'Jeff Bezos spent more on this house in Beverly Hills than Amazon has paid so far in

federal corporate income tax for 2019' by *MarketWatch*, a Dow Jones media website.

At first glance, US$162 million seems a lot. Except that it's a mere 1.2% of the company's US$13.9 billion pre-tax income. A drop in the ocean, given that the average American pays 14% in income tax…and they don't have the cash buffer of a Nasdaq company.

RESHAPE THINKING

In the deepest global recession since World War II, former Federal Reserve Chair and economist Ben Bernanke, in comments to the *Washington Post*, characterised this trough as "an even more unequal recession than usual".

"The sectors most deeply affected by Covid disproportionately employ women, minorities and lower-income workers."

Nowhere is this felt more acutely than in countries where economic inequality was already high before the pandemic hit. In India, where the growth of inequality is the second highest in the world, the rich held 4x more wealth than the bottom 70% of the population. Within five months of the pandemic, Mukesh Ambani, Reliance Group Chairman and Asia's richest man, had amassed over US$48 billion in net worth, doubling it to over US$80 billion, making him now the fourth richest man in the world.

In contrast, the Indian economy contracted 23.9% in the first quarter of 2020, coupled with ILO predictions that 400 million workers in India's informal economy will fall deeper into poverty. The following commentary by the *Financial Times* is reflective not just of India, but almost every country in the world:

"Abhijit Banerjee, the Nobel Prize-winning economist, warns that if millions of households slide into chronic hunger and indebtedness they will be a drag on India's economy for years.

"There has been a huge income shock to the people who are most illiquid and who will not be able to finance consumption by borrowing," he says. "If they don't revive their consumption, this then leads the whole economy to shrink. India should worry about a demand slump. Whenever the economy is allowed to revive, people will not have money to spend."

Cash transfers work – whether in the form of the furlough deal in the UK, with the government paying a percentage of worker salaries throughout the pandemic, or direct cash transfers into bank accounts such as Malaysia – when applied with longer-term and less obvious means of keeping the economy afloat.

Central banks have been quietly and deftly working the machinery of finance through asset purchases and bond buying to loosen the binds that constrain the economy, keeping confidence levels and markets afloat. What's changed since the last crisis is that many regulators are now including inequality measures in their policy analysis.

An IMF working paper, *Should Inequality Factor into Central Banks' Decisions?*, released this September, captures important dimensions of unequal wealth distribution. Its findings support making inequality an explicit target for monetary policy in tandem with other goals such as targeted unemployment levels and inflation rates.

Its authors Niels-Jakob H Hansen, Alessandro Lin, and Rui C Mano frame their study thus: "Should central banks care about inequality when setting monetary policy? Up until recently this question was a non-starter among policy makers and academics.

"First, inequality is typically outside central banks' mandates. Second, an early literature showed that inequality of wealth or income did not distort the aggregate transmission of shocks. However, major central bank officials are increasingly discussing distributional issues. At the same time, advances in economic theory have shed light on the role of inequality in the transmission of monetary policy."

A blog post by the Economics Policy Institute concurs but through the lens of private sector agents. The authors, Heather Boushey and Somin Park from Washington Center for Equitable Growth, wrote: "When Moody's Analytics' chief economist Mark Zandi integrated inequality into the Moodys.com macroeconomic forecasting model for the United States, he found that adding inequality to the traditional models — ones that do not take into account economic inequality at all — did not change the short-term forecasts very much. But when he looked at the long-term picture or considered the potential for the system to spin out of control, he concluded that higher inequality increases the likelihood of instability in the financial system."

'SHAMEFUL ACTS'

It is a crucial shift in mindset. Addressing distributional issues at the policy level can mitigate a range of last-mile distribution issues which have plagued this round of disbursements.

Consider the Coronavirus Aid, Relief, and Economic Security (CARES) Act, America's historic US$2 trillion budget to directly assist millions of citizens as well as businesses.

The emergency distribution was approved by US Congress, which mandated Internal Revenue Services to credit monies direct into individual bank accounts. One oversight though – some 14.4 million Americans are 'unbanked', i.e. do not have bank accounts and had to wait weeks or month before they could receive their stimulus cheques by mail. Ooops.

Once that long-awaited stimulus cheques did arrive, over-the-counter consumers were charged anything between 1% and 10% to cash that cheque. One aid recipient told the *Associated Press*, "They charge you an arm and a leg…You never get your full money. It's bad, but I have no other choice."

Data from international agencies and national authorities indicate that the majority of unbanked and underbanked in our midst are likely to be from lower-income households, less-educated, younger, persons of colour, disabled, or households with volatile income.

Additionally, the US government's Paycheck Protection Program (PPP), a stimulus package designed to extend credit cheaply and directly to small businesses, also faced criticisms when it was distributed. With interest rates set at 1% and the possibility of debt forgiveness if companies abide by employee retention and disbursement criteria, the idea behind PPP was to keep mom-and-pop stores alive, unemployment at manageable levels, and spur local spending.

In April, brickbats were thrown when it was discovered that at least US$250 million in PPP money was disbursed to public listed companies and big businesses, some with market values in excess of US$100 million and were already loss-making before the pandemic. These big businesses only returned PPP monies to government coffers when the media exposed the findings on the back of research produced by JP Morgan and other analysts.

Howard Schultz, former Starbucks chairman and CEO, told CNBC, "I think you've seen some pretty shameful acts by some large companies to take advantage of the system" and that government should act "as a backstop for the banks to give every small business and every independent restaurant a bridge to the vaccine. And that is the money and the resources to make it through."

MYTH-BUSTER

The CARES Act and PPP fracas exemplify the uphill battle faced in closing the wealth gap.

\+ **Firstly, allocating credit is not good enough.** Time is of the essence. The immediacy of credit reaching the hands of intended recipients impact cash flow and can either accelerate or decelerate the rate of recovery. Inequality widens when money is available but out of reach because the connecting pieces needed to access that credit are woefully missing. Also, transaction costs such as service charge when cashing out stimulus cheques could (and should) have been waived as part of disbursement instructions coming out of Washington – 'taxing' benefits in this manner sends the signal that one is profiteering and reduces the level of disposable income.

\+ **Secondly, direct cash transfers give people purchasing power, so make sure it gets in their hands.** Some argue that unconditionally putting cash in the hands of beneficiaries who are poor will see it squandered on non-essentials

such as alcohol. This is refuted in findings by economists such as Johannes Haushofer and Jeremy Shapiro, who show that unconditional money transfers in countries like Kenya had two effects: (1) beneficiaries spent significantly more on food, education, and health; (2) unconditional cash transfers form a social safety net for the poor that can counter rising inequality and social discontent.

+ **Thirdly, fintech is not the be-all and end-all solution**. Research show that just like banks, fintechs are driven by economics that don't necessarily enable financial inclusion. This is known as 'cream skimming', a metaphor used to describe the business practice of servicing only high-value or low-cost customers, disregarding clients that are less profitable. Like banks, financial technology firms have economic imperatives that make it difficult for them to facilitate meaningful levels of financial inclusion. We recommend reading the 2018 study, *FinTech Borrowers: Lax Screening or Cream Skimming?,* by Marco Di Maggio and Vincent W Yao for insights into this lesser known aspect of fintech behaviour.

+ **Fourthly, most of the unbanked do not have ready access to or are unfamiliar with mobile technologies.** The Brookings Institution's research paper, *The Post-pandemic, Socially Conscious Transformation of American Banking in a Digital World,* found that in principle, fintechs should make banking more attractive for the unbanked since these technologies have the potential for lowering the costs of banking. In practice however, certain segments of the unbanked – senior citizens, the homeless, urban poor – are likely to be less familiar with mobile banking than the rest of the population. A 2017 Federal Deposit Insurance Corporation survey also points to the lack of sufficient funds, lack of trust in banks, and account fees as the top reasons for why the unbanked opt out of the banking system…and stay that way.

Some out-of-the-box solutions have been proposed:

"We have done research at the IMF that clearly demonstrates that five years after SARS, or H1N1, **WE WOULD GET 5% MORE UNEMPLOYMENT** among the poorer part of the population. So if we don't want to come on the other side of this pandemic weaker, we ought to integrate [an] inclusive approach to growth to the response to the pandemic right now. We must be very mindful that, unfortunately, history tells us pandemics deepen inequality

+ **Create a public option for basic banking services.** Using existing post offices or the postal system to deliver stripped-down savings accounts, this increases uptake on the deposit side with super-low or no maintenance and overdraft fees, incentivising unbanked or underbanked households to keep an account.
+ **Reform your tax system,** advises Kristalina Georgieva, managing director of the International Monetary Fund (IMF), when asked on the solution that would give policymakers "the biggest bang for their buck in the near term". US lawmakers have certainly taken this to heart and straight to the voting floor. Former presidential nominee Senator Bernie Sanders has tabled the Make Billionaires Pay Act – a 60% tax on windfall wealth increases of the richest Americans which will go towards paying for medical expenses for Americans for a year. At last count, the potential taxable sum is US$731 billion accumulated by 467 billionaires or the richest 0.001% America.
+ **Stop illicit financial flows to curb.** Crisis or no crisis, the European Banking Authority warns that money laundering will continue. Transparency International reports that illicit financial flows drain Africa of US$50 billion annually, funnelled abroad using offshore financial structures with the help of complicit or negligent banks, lawyers, accountants, and real estate agents. Such leakages are a key driver of economic inequalities. As an example, the organisation states that in the aftermath of the 2008 financial crisis, banks laundered drug money amounting to US$352 billion, and professionals such as financial advisers were involved in looting funds for responding to the Ebola crisis. Strengthening the global AML system's front-line defences is key. For updates on the AML front, read our story, *AML Compliance Hanging on a Wire,* on page 20.

HISTORY'S BOGEYMAN

Georgieva sums it best: "Inequality holds growth back."

Speaking via remote interview this October at a *Barron's* conference, she estimates that 90% of the world will finish 2020 poorer than when they started, with 90 million more falling into the poverty bracket in addition to the world's existing 760 million poor.

"We have done research at the IMF that clearly demonstrates that five years after SARS, or H1N1, we would get 5% more unemployment among the poorer part of the population. So if we don't want to come on the other side of this pandemic weaker, we ought to integrate [an] inclusive approach to growth to the response to the pandemic right now. We must be very mindful that, unfortunately, history tells us pandemics deepen inequality."

Turning the tide on global inequality requires that we keep our nose to the grindstone and fix the gaps. Finance has a crucial role to play in the redistribution of wealth and ensuring our children inherit a more equitable world. Question is: Are we all in this together? ✱

■ *Kannan Agarwal is a researcher with Akasaa, a boutique content development and publishing firm with presence in Malaysia, Singapore, and the UK. His focus is digital content and Big Data analytics.*

REDEFINING RELATIONSHIPS

By Chartered Banker Institute, UK

BANKS CAN RETAIN CORPORATE CUSTOMERS IN THE POST-PANDEMIC ERA – BUT THE PRICE MAY BE LOSING BRAND OWNERSHIP OF THE RELATIONSHIP

At the height of the pandemic, fintechs and challengers in the banking space saw an opportunity to support businesses in need – and demonstrate their own credentials.

Iwoca, for example, launched its OpenLending platform with a clutch of partners, claiming it would provide micro-businesses with "fast and digital access to finance at a crucial time". And Trade Ledger forged a 'taskforce' with fintech peers Wiserfunding, Nimbla and NorthRow, with a similar mission to channel funds to struggling small- and medium-sized enterprises (SMEs).

The bottleneck was to be at least partly eased by the Chancellor's introduction of bounce back loans. But Trade Ledger Founder and CEO, Martin McCann, says now: "There was a huge issue with cash flow liquidity, and we could see a need in the market that wasn't being fulfilled to solve the short-term needs of SMEs.

"In terms of sheer scale of need, this was wartime – and peacetime capacity just wasn't working."

RACE TO THE CLOUD

Now that the war is abating, who is best placed to serve the banking needs of battle-scarred businesses?

Business-facing banks have come into their own in the sense of supporting businesses to forge useful connections, review their supply chains and adapt their business models to the new reality. Their deep knowledge of clients and the sectors they operate in is now more valuable than ever.

Where corporate banks have fallen behind the challengers – and even their own retail operations – is in the deployment of open application programming interfaces (APIs) to serve clients more efficiently. That gap was mercilessly exposed by borrowing experiences during the pandemic.

As a result, digital investment programmes that might have been expected to stall amid a major crisis are instead being stepped up, according to Sankar Krishnan, Executive Vice President of Capital Markets and Banking, Capgemini. "There is increased spend at the banks as they pursue digital at a pace faster than anyone thought," he says.

One priority is the replacement of the creaking payments infrastructure: "What is coming out of the pandemic clearly is the need for a faster compute. Our number one business now is the move to the cloud – every bank is asking how they can do this."

TECH POACHERS

Cloud migration is a good start. But in the face of competition, incumbents may finally need to embrace single-platform partnerships if they are to retain their share of the business market.

One route is via Big Tech. This summer, Goldman Sachs led the way by teaming up with Amazon to introduce lending facilities for sellers using the tech giant's marketplace. With sellers' consent, Goldman will be able to use the businesses' revenue data from the platform to support credit approvals, according to initial reports on the deal.

The move follows last year's deal in the retail current account space involving Citi and Google. At the same time, tech has begun to poach senior banking figures – Bank of America CTO Howard Boville now heads IBM's cloud division, while in June, Google Cloud hired Citi Fintech CEO Yolande Piazza.

"We are going to see a lot of experienced bankers move to Big Tech over the next few years," Krishnan predicts. "They bring good knowledge of financial regulations and how real-time payments work."

BANKS: THE NEW INTEL?

He sees the Goldman/Amazon deal as

a win for all concerned: "By partnering with financial brands and being the liquidity provider, they can provide a better deal for their SME sellers. It creates more stickiness and a new revenue stream for Amazon. And for the bank, it makes it a lot easier to access borrowers."

The fear in partnerships such as this is that the brand loses its importance as a differentiator, leading to the loss of bank ownership of the customer relationship. But in its latest *World FinTech Report*, Capgemini argues that banks need to embrace platform models if they are to avoid being reduced to the status of 'data pipes', transferring data from one point to another without any input.

Krishnan believes banks can afford to play to their strengths within new joint ventures. He cites the 'Intel Inside' marketing campaign for microprocessors that became ubiquitous in the 1990s: "The competition now is going to be, which of the banks will be the 'Intel Inside' of your marketplace?"

McCann agrees: "The banks that get on top of this trend can be the providers of better credit and business banking through an omni-channel infrastructure. They will still have their own branded services, but they will also be able to provide those within an embedded proposition.

"The banks that get to that point first will see massive service shifts in their favour. Those that miss out will become utilities."

COLLABORATION WAVE

The other obvious route for banks is to create platforms in collaboration with fintechs. They have the appeal of innovative capabilities, but without the threat that Big Tech poses of disintermediation of the banking sector.

If banks are keener than ever to collaborate to ride the digital wave, the time may also be ripe for fintechs. Investor confidence in fintechs fell during the pandemic, resulting in a drop of over a third in investments in the first half of 2020 compared with the same period last year. While still upbeat about the sector's prospects, Innovate Finance, the industry body, says three-quarters of smaller fintechs are concerned about their next funding round.

McCann predicts a rush of new collaborations. He says banks in dialogue with Trade Ledger, and which previously saw digitisation of business lending as a three-year project, are now looking to deploy this within nine months.

He says fintechs will be able to equip the banks to deal better with origination and onboarding of new SME clients, as well as streamlining credit decision models. New platforms will also require a new offering: "The traditional products are not going to cut it for large sectors of the market that need recapitalisation."

SEAMLESS LENDING

For McCann, the time has come for Open Finance – a 'banking-as-a-service' model centred around ecosystems rather than institutions. Trade Ledger's vision is of digitised lending as an infrastructure layer that is available seamlessly when businesses need it – at the point of reconciling their monthly accounts on Xero, or while buying inventory on the Amazon Marketplace.

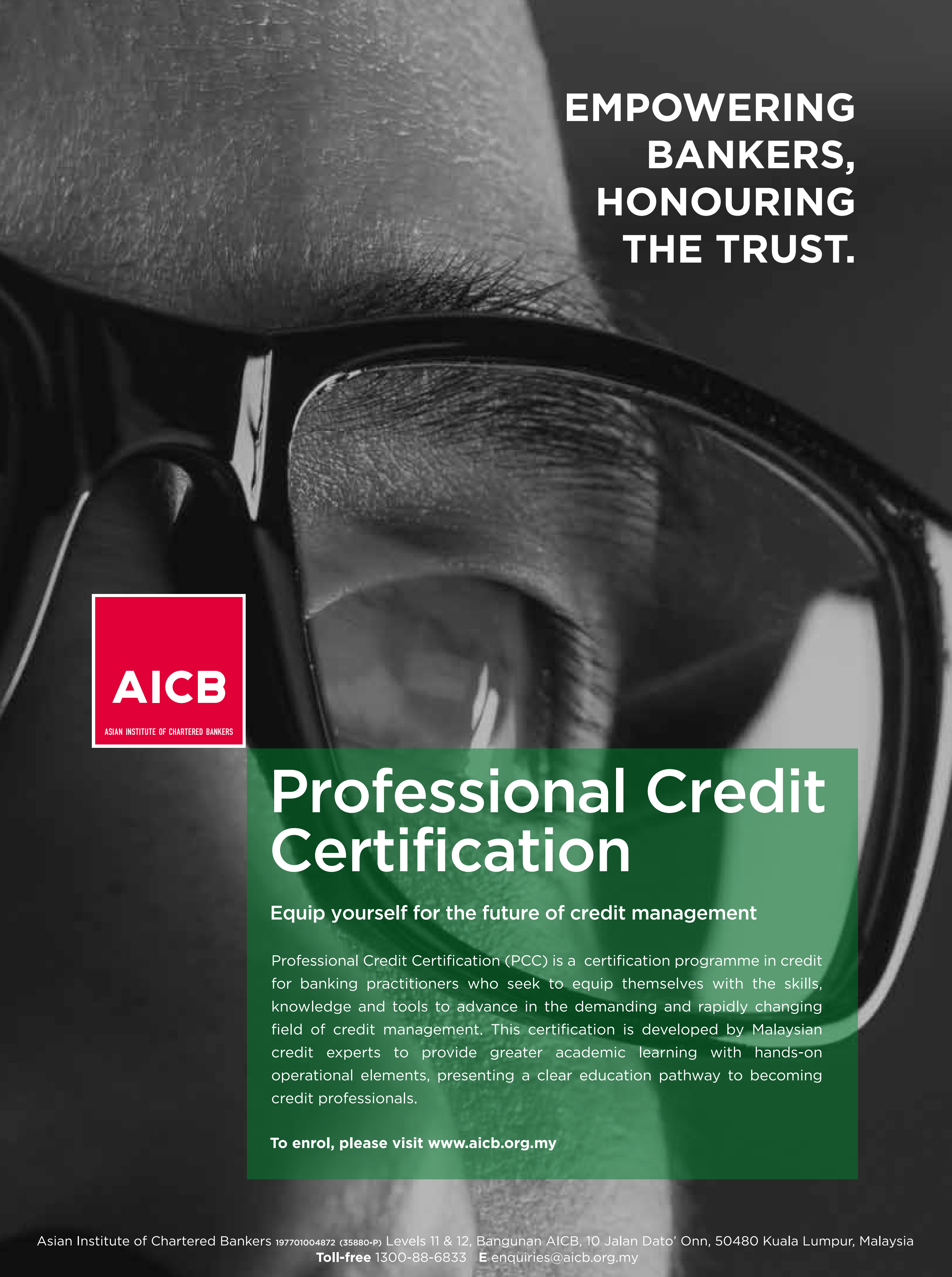
He discounts concerns about business' reluctance to open up their data, which would be required for such systems: "There needs to be a packaging and proposition effort to explain why it's in the business' interest.

"Smaller businesses tend to have a lower level of financial literacy. They don't necessarily understand where they are in terms of creditworthiness or even their cash flow position. If you can build a proposition that helps the business to solve these problems, that would encourage them to connect to more data sources."

Krishnan hopes the gloomy statistics of the Capgemini *World FinTech Report*, published in April, are already out of date. In that snapshot, only 21% of banks said their systems were agile enough for collaboration, while 70% of fintechs didn't see eye to eye with their bank partner in a cultural or organisational sense. The next report, Krishnan predicts, will reveal a transformed picture: "My hope is that we will see a lot of activity in the first quarter of next year."

McCann sees an even faster shift: "By the end of this year, I think we'll see a number of UK banks announcing significant new digital products to help with credit, liquidity, treasury and other transactional banking requirements, particularly at the smaller end of the market. There's no way we're going back to normal after this." ✱

■ *This article previously appeared in the Chartered Banker magazine, UK, Autumn 2020 edition.*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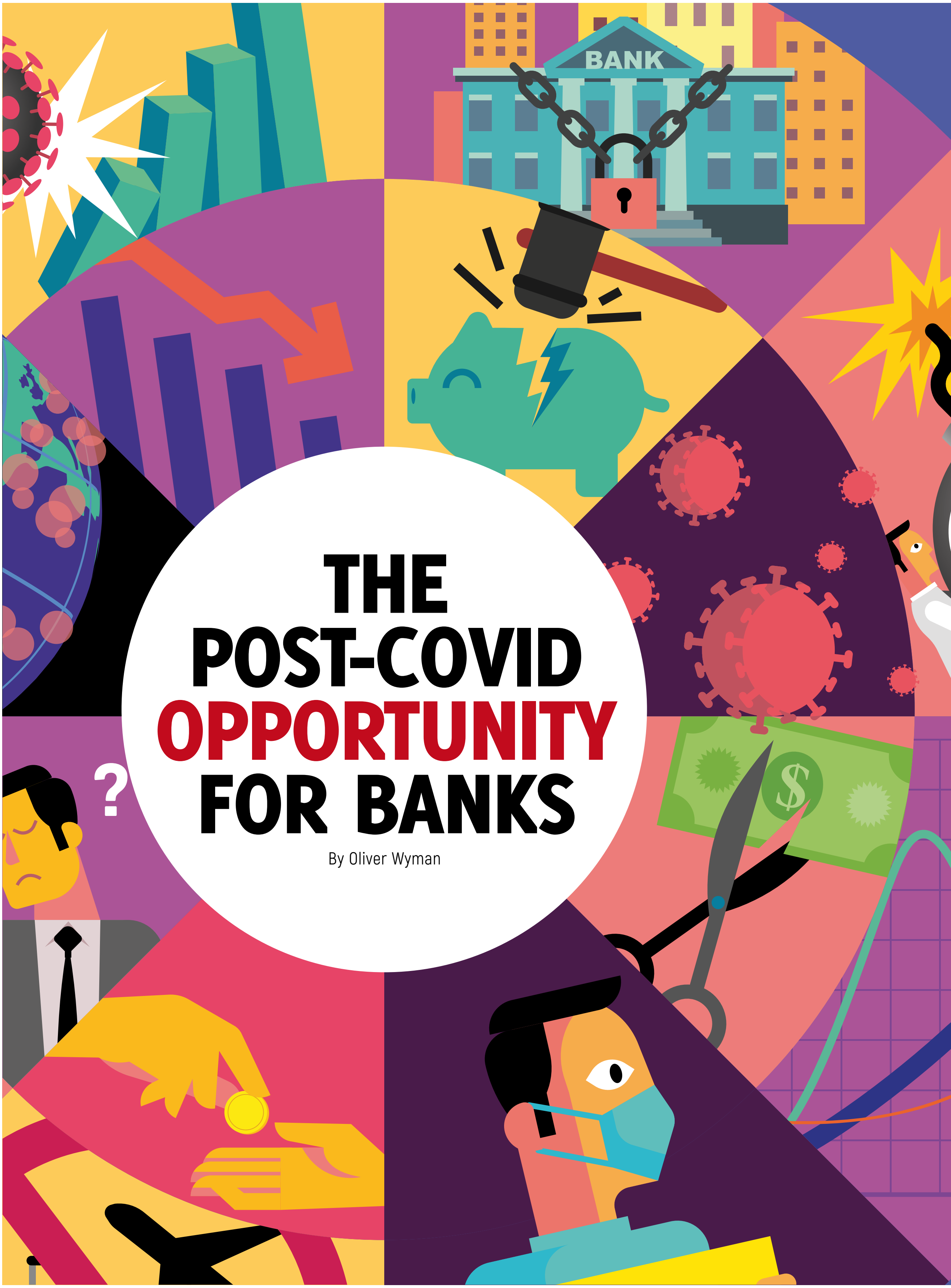


THE POST-COVID OPPORTUNITY FOR BANKS

By Oliver Wyman

Leaders must take a proactive stance to ensure proven technologies and approaches that work during the crisis are made permanent.

With more than 50% of the world in lockdown of various forms, a nosedive in global trade, and a forecast 3.8% decline in GDP, the Covid-19 pandemic has brought an unprecedented halt to normal life. This has led to fundamental changes in behaviour both externally in terms of customer activity, and internally in how firms are able to engage and operate. These changes are here to stay across three dimensions of activity, and firms need to thoughtfully adapt in order to thrive.

1 CUSTOMER BEHAVIOUR

While the trend is not new, the pandemic has acted as an accelerator for digital adoption.

A large spike in digital channel utilisation during the Covid-19 pandemic has been observed across banks and markets and many expect increased usage to persist. Following lockdown announcements, one of the leading Southeast Asian (SEA) banks saw 10,000 new customer account applications through the mobile banking app in a period of three days. Another saw more than 100 million more digital banking transactions as compared to the same period in 2019, and a third saw a more than a 200% growth in online investment accounts. There has also been a sharp growth in digital payments. In mature Asian markets, over 100% growth in digital payment usage has been observed, with e-commerce transaction value rising 40%. In emerging Asia, there was 260% growth across two real-time electronic payment systems in the Philippines. Conversely cash usage has declined, with ATM transactions falling as much as 60% in some markets.

2 WAYS OF ENGAGING

Engagement between banks and their customers has also changed fundamentally. Previously suggestions of video-conference relationship manager meetings would have been met with strong resistance on both sides. However, forced to move to digital modes of communication by lockdowns in many markets, outcomes have been largely positive. Many banks have found that engagement between relationship managers, sales teams and clients have increased as compared to pre-Covid with coverage teams' client servicing load also increasing for some banks. Without lengthy commutes, particularly in some Asian markets, relationship manager efficiency has increased by up to 30%–40%. There have also been a couple of instances of investor events hosted virtually with more than 5,000 attendees, almost double the attendance of a standard in-person event, with even more positive feedback received when compared to prior events. Of course, the challenge is whether the higher levels of engagement would work in a 'virtual for longer' environment, with fewer 'organic' conversations, and how relationships can be built with new customers through virtual modes.

3 WAYS OF WORKING

Pre-crisis, the banking world had a general perception that remote working would lead to lower productivity, be unable to hold workers to account using the traditional 'clocking in/out' mechanisms. With 40%–80% of bank employees working from home during lockdowns, these strongly held notions have been put to the test. What has emerged is a demonstration that remote working is just as productive, if not more productive, given other savings (time spent commuting, for example) than working from an office. However, a high asymmetry of productivity has been observed. Many are reporting skews where up to 70% of the output is coming from as few as 20% or 30% of the employees. This may be partially a result of the shift to remote, however it is more likely that the current environment is just exposing the large productivity skews that already existed in the system. Whilst highly dependent on the country and therefore the typical size of homes, many are also valuing the flexibility. A leading Australian bank found, in surveying its employees that had been working from home, that 80% of them wanted to maintain the greater flexibility it affords. Many of the leading banks in Southeast Asia are also now in the process of surveying their employees.

Another important efficiency gain has come from the decentralisation and often short-circuiting of decision-making. Many banks have found that the new ways of organising and managing teams have enabled them to better manage spans of control and layers to improve efficiencies during Covid-19. Others have reported a huge increase in speed of transformations, "tasks that would take six months to do are now getting done in two weeks." This is a result of several factors, but one key component is the short-circuiting of decision-making. For example, a large global bank had 72 different approval gates and committees to sign off on a new product pre-Covid and this has now been reduced to seven.

Many institutions are seeing these shifts as an opportunity for lasting and profound change.

A significant change in the balance of activities necessary to survive and differentiate is expected to ensue, providing opportunity to re-establish the survival and strategic minimum. In some sense the real 'survival minimum' has been practically tested during lockdowns with initiation of business continuity measures, for example, shutting offices and branches, trimming service hours, reducing products and features, and technology constraints such as virtual private network outages. In other words, a real-life zero-basing exercise has been carried out. A new 'strategic minimum' is also emerging, challenging many aspects of the organisation that were previously considered essential, such as large real estate facilities. (**See Exhibit 1**)

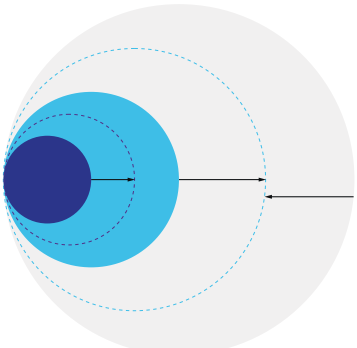
Whilst there are opportunities emerging, the crisis is also making change mandatory. Contracting economic activity, growing loan provisions, and expense increases for additional customer support and resilience requirements are already taking a toll on bottom lines. These headwinds exacerbate the impact of existing commercial challenges for financial institutions, given low interest rates and stiffer competition from market disruptors. The huge pressure placed on profitability is driving both objectives around growth and efficiency. Banks are looking to unlock new revenue streams and capitalise on the Covid-19 driven market and behavioural changes.

Profitability pressures are also bringing about inevitable cost management imperative. Whilst banks in Europe and North America have been undertaking large cost management programs since the global financial crisis (GFC), the banks in Southeast Asia have been still enjoying double-digit returns on equity (ROEs). However, they too were starting to face net interest margin and RoE contraction and beginning major cost management and branch reduction exercises. Whilst banks are currently facing substantial pressure to preserve jobs, given the observations around productivity and profitability pressures, a wave of cost-cutting programmes is inevitable. The crisis has also revealed several vulnerabilities in the operating model, ranging from increased cyberattacks, stability of technical architecture and increased transactions volumes, to operational constraints from off-shore centres ill-equipped to shift to remote working. Taking all these factors into consideration, objectives around growth, efficiency and resilience will be at the heart of rethinking a 'new normal.' (**See Exhibit 2**)

It is unclear how permanent all the changes will be. However, most believe that returning to the 'old normal' is no longer an option. Furthermore, for many of the changes there will be a window of opportunity that will close upon return to offices, unless leaders take a proactive stance to ensure permanency. Examples include many of the productivity gains, improved speed of delivery and decentralised decision-making. We urge organisations to first start thinking through a set of plausible scenarios to feed into their strategic planning, and then proactively start to examine the changes required to thrive in an environment of persistently lower rates, growth and margins. (**See Exhibit 3**)

Exhibit 1: Defining the strategic minimum in the 'New Normal'

Re-establish the strategic minimum using zero-basing methodology in the 'New Normal'



Arrows represent the potential shifts in boundaries between survival minimum, strategic minimum and discretionary spend

Survival Minimum

What is necessary to ensure required functionality?

Has the crisis re-defined what our survival minimum really is?

Team size

"Before this, I thought everything my function did was critical. We're running at 30 per cent capacity right now and the institution is fine. I need to revisit my views on critical activities once this is over."

Chief Risk Officer, UK Financial institution

Strategic Minimum

What is critical to implementing strategic objectives?

Has the crisis re-defined what our strategic minimum really is?

Real estate facility

"Putting 7,000 people in a building may be thing of the past … there will be a long-term adjustment in how we think about our location strategy, and will not revert fully to its pre-January working habits."

Chief Executive Officer, Global bank

Discretionary

What is unnecessary internal demand/non-value add activities?

Are there additional previously discretionary activities that are now part of the strategic minimum?

Cyber risk spend

Exhibit 2: Critical post-COVID business objectives

Revenue pressures

Growth
Unlock new revenue streams and capitalise on COVID-driven market and behaviour changes

Cost management imperative

Efficiency
Redesign processes and systems to leverage advanced technology for efficiency and reduce cost pressures

Continuity vulnerabilities

Resilience
Insulate the business from future shocks and continue to serve customers in a safe, secure and optimal manner

Exhibit 3: Continuum of post-COVID behavioural scenario

	The Old Normal	The New Normal
Customer behaviour	Digitally-active customers bank online, relying on physical channels only for more complex transactions. Others still visit branches for most transactions	More customer segments adopt digital channels for basic transactions. Digitally-active customers are able to carry out complex transactions online
Ways of engaging	Broad branch network; Relationship management transitioning to online but is done primarily via high-touch interactions for HNWI/UHNWIs, SME & corporate segment	Significant reduction in branch capacity. More digitally-led meetings across segments. Greater use of digital tools and analytics to empower RMs in personalising recommendations
Ways of working	Most staff work on premises, hosting in-person events and travelling for meetings	Significant increase in remote working arrangements and use of VC/other remote collaboration tools; reduced international travel

Magnitude and permanency of "in-crisis" changes dependent on:

Market forces — **Institutional factors**

Low — High

Duration & frequency of lockdowns	Stringency of regulations	Maturity of IT/digital infrastructure	Nature of business function/ service	Market position and influence	Customer/ employee preference

Source: Oliver Wyman analysis

THE NEW NORMAL

Defining a 'new normal' for business operations has implications across strategy, operating model and organisational design. Whilst many responses are not new (**see Exhibit 4** for the full list of initiatives), for example in technology around process digitisation, or adoption of more scalable, front-to-back architecture, the level of management attention and pace at which institutions are looking to achieve the transformations has changed significantly. For example, banks are looking to convert three-year digital roadmaps to 12-month roadmaps, and similarly for branch optimisation programmes. However, while we are seeing organisations focusing on specific initiatives, we have not observed many taking a holistic front-to-back review. There is a high degree of synergy and linkage between initiatives. For example, branch strategy must be paired with the advancements in digital servicing and creation of interactive digital channels; HR cannot review talent requirements in isolation from understanding proposed new business models; technical architecture must be designed around considerations of remote working and associated access, security and redundancy. Large strategic programmes also cut across these initiatives (**see Exhibit 5**), including cost management programmes, digital acceleration, resiliency programmes, etc. Cost programs will be a derivative of many of the initiatives around digital acceleration, change of business model, productivity and so forth; digital acceleration work will run front to back and resilience will be at the heart of many infrastructure and operating model considerations.

Covid-19 has accelerated many trends that were already underway and it has proven technologies and approaches which were underutilised. Ways of working will not return to the status quo ante; underlying profit and its drivers cannot. Businesses have to remodel and those who take time to review the myriad design options and their ramifications as a single, strategic review of the connected whole, will be those who emerge strongest from the crisis. ✱

Exhibit 4: Initiatives for a re-envisioning a 'New Normal' business strategy, operating model and organisational structure

1. Business Model

1.1 Launch new digital business models
- Build in configurability & customer centricity in products & services
- Enhance interactive digital channels to manage complex transactions through self-service
- Refine your long term digital business model strategies, considering adjacent models and propositions to create new revenue sources

1.2 Redefine customer relationship model
- Accelerate streamlining of branch network
- Equip relationship management and sales for digital first services
- Enable effective customer service through digital

1.3 Explore ecosystem plays
- Accelerate partnerships with ecosystems & marketplaces to increase breadth of offerings

1.4 Modify the business mix
- Redefine geography strategy
- Explore inorganic opportunities

2. Operating Model

2.1 Champion a digital first foundation
- Accelerate end-to-end digitisation via automation, AI & workflow across the value chain
- Embed data-led digital decision making at all levels of the organisation
- Create a low cost, digital, scalable and robust foundational architecture by migrating to cloud & SaaS

2.2 Rebalance resourcing and location strategy
- Re-evaluate location strategy: onshore vs offshore and inhouse vs. outsource, to optimise cost variability and concentration risk; consider dynamic workload allocation capabilities
- Analyse need for fixed vs. contractor workforce

2.3 Drive further efficiency and productivity
- Reprioritise project portfolio to fully address accelerated trends
- Re-evaluate corporate real estate strategy to align with changes to remote working

2.4 Resilience by design
- Build on-demand sourcing and workload allocation, to shift demand-supply with ease within an established network
- Improve third-party resilience analysis, controls environment, reporting and monitoring in light of crisis learnings
- Understand the impact of 'New Normal' on vulnerabilities landscape and re-evaluate cyber controls to enhance resilience
- Prioritise & enhance critical infrastructure for improved technical resilience

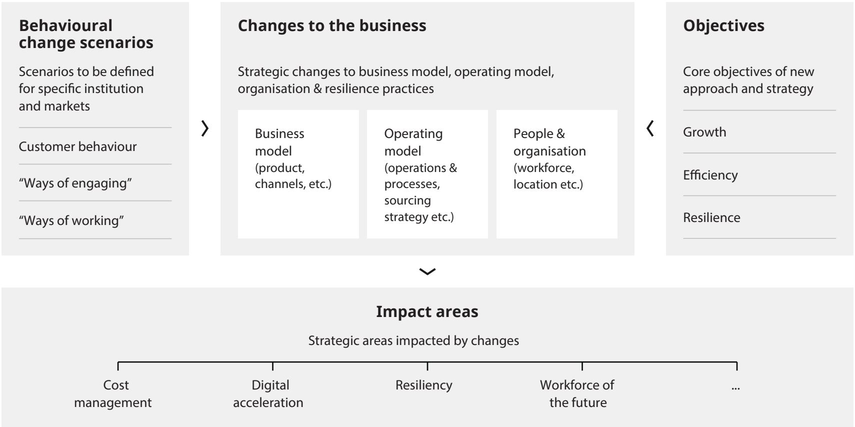
3. People & Organisation

3.1 Upgrade workforce for the future
- Identify new roles and responsibilities to drive new business model
- Hire and redirect talent for evolving R&Rs
- Reconfigure training & upskilling for existing workforce

3.2 Build an agile, resilient organisation
- Institutionalise organisational agility & speed to response to build a customer first culture
- Shift to a digital & remote working model to maximise effectiveness and minimise future business disruption

3.3 Take a new lens on business culture
- Shift to culture of productivity by empowering employees and aligning incentives
- Develop internal and external communication to suit new working arrangements
- Initiate employee health and wellness programmes for changing environment

Exhibit 5: Framework for considering impact of COVID, critical objectives, changes to the business and strategic areas of focus



Source: Oliver Wyman analysis

■ *Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialised expertise in strategy, operations, risk management, and organisation transformation.*

CHANGE AND THE FAST AND FURIOUS FUTURE

By Derek Ariss

Prepare to surf the waves of change coming your way.

Welcome to an incredible time of change! In previous articles, I have stated that technology drives the rate of change at an ever-increasing speed. Now I am saying that technology and environmental shifts are creating change faster than before!

Everywhere we look, there are modifications, alterations, and adjustments going on. Governments are shifting, the 'New Normal' created by Covid impacts how we work, travel, transact, and communicate. Underlying all of this is still the theme of digital technologies.

How do we manage? What are our coping tools to steer through this ever faster-paced future? We want to be able to come out of this positive, refreshed, and in control.

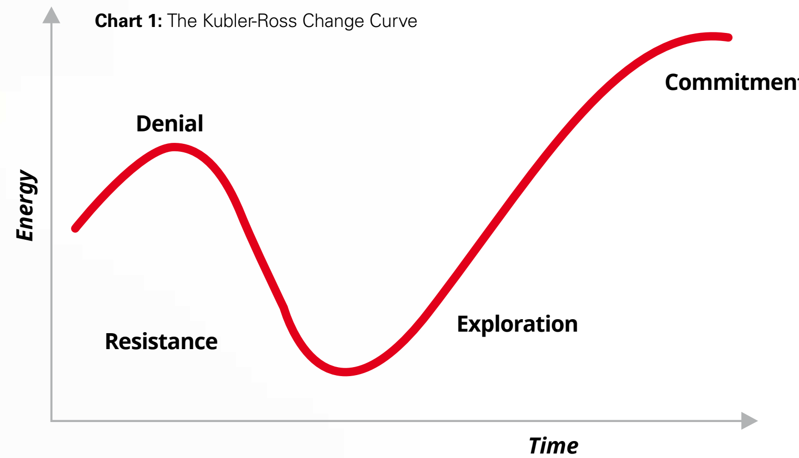
In this article, we will present a cross-section of information by examining change. We will look at how we react to change, and how we can improve the reaction. In addition, we will present the skills we need to develop and make riding the wave of change positive, productive, and exciting.

EXAMINING CHANGE: THE BIG WAVE

The other day I was mesmerised by a simple photograph. It was a picture of a beautiful and massive wave that was hurtling towards a nearby coastline. It wasn't the wave that caught my attention as much as the small figure near the bottom. The figure was a surfer riding the wave. Even though the wave was huge, powerful, and overwhelming, the surfer decided to harness its energy and use it to create the ride of a lifetime.

This picture represented to me the present. It is a time of adjustments, reinvention, and resilience, which we all need to pass through.

Chart 1: The Kubler-Ross Change Curve



Whether it is applying artificial intelligence in our business, the impact of automation on our supply chains, or even the social impact of working from home, the new wave is here. We need to deal with it well. Just like the surfer in the photo, we need to harness the power of the 'wave of change' and deliver a great ride through it.

UNDERSTANDING CHANGE: THE KUBLER-ROSS MODEL

The study of how people deal with change has been a point of interest for a long time. One of my preferred structures explaining how people deal with massive shifts in their lives comes from the psychologist Elizabeth Kubler-Ross. In 1969, she created a model which describes the behavioural stages that people go through when they lose something important and meaningful. We all go through these stages when dealing with significant change. Let's take a closer look (see **Chart 1**).

> **Stage 1: Denial.** When a person realises that change has happened, they often believe that the situation they are going through is not really occurring. People in this first stage hope that the situation will just go away. Here, people need time to process the information. It's a little bit like an ostrich burying its head in the ground because it is frightened. The ostrich thinks if it ignores the cause of the fear, it will then disappear.

> **Stage 2: Resistance.** In the next stage, known as the 'resistance' stage, a person realises that the change is real. Denial is no longer possible. They need to accept the circumstances, but they feel they have lost something that they are comfortable with. Often, here, people get slightly irritated and angry.

They become upset because the future is unclear.

- **Stage 3: Exploration.** In Stage 3, the person reaches a point where getting angry will not make the situation any better. They start examining and testing out possibilities.
- **Stage 4: Commitment.** The final stage of the model is called 'commitment'. This stage occurs once the person has accepted the 'New Normal'. When people reach this stage in the cycle, they become more forward thinking, confident, and engaged. It is here where people start learning, growing, and seeing the change as positive.

Hence, if there is a meaningful change, be it learning a new operating system, applying a digital transformation programme, or even utilising video conferencing as a primary communication source, people must go through all four stages.

Understanding that all of us need go through these stages once any major change happens is important. We all take different amounts of time to pass through Stages 1 to 4. This explains why we see people at different stages in the change cycle as we all adjust to the 'New Normal' in the world.

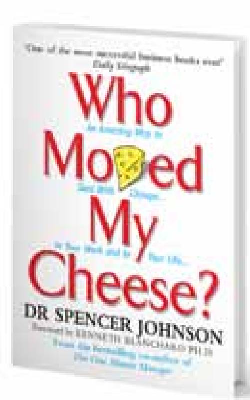
You may be asking, "Is there a way of minimising the negative effects of the change cycle?" Yes there is, and one potential answer lies in a *New York Times* bestselling book called *Who Moved My Cheese*.

DR SPENCER JOHNSON, WHO MOVED MY CHEESE

Dr Spencer Johnson was a physician and author, who wrote a series of books on management and change. His most popular book, a *New York Times* bestseller, is called, *Who Moved My Cheese*.

The book is a parable that discusses how to deal with change in work and in your personal life. It anchors around the pursuit of 'cheese' (things that make you happy in your life). The story takes place in a maze and the four characters that are living in it. They are constantly looking for 'cheese'.

THERE IS SO MUCH 'CHEESE' in fact, that they don't have to keep searching every day. This is where things get interesting because the characters react differently to one another.



Each character in the story represents qualities within us.

- Sniff is continually looking for new change and is ready for it;
- Scurry goes into action immediately without needing to know all the information;
- Hem likes to stay in a safe and familiar territory; and
- Haw is slow to adapt to change but willing to learn.

The story's summary: Each day all four characters run into the maze and look for 'cheese'. Sometimes, they find 'cheese' in parts of the maze; other times, they don't find 'cheese'. In either case, they always seem to survive.

One day Sniff, Scurry, Hem, and Haw all find a location with a lot of 'cheese'.

There is so much 'cheese' in fact, that they don't have to keep searching every day. This is where things get interesting because the characters react differently to one another.

Sniff and Scurry still keep looking for new 'cheese' every day.

Hem and Haw count on their past experiences and don't worry about looking for new 'cheese'.

Over time, however, the 'cheese' supply slowly diminishes (we can all relate to this).

The story then focuses on how each of the characters reacts to and manages the

change.

Sniff and Scurry did well; they kept adapting to changes. Haw, who was slow at dealing with change, eventually accepted the change, and learned from Sniff and Scurry. Haw went back out to the maze and started finding new 'cheese' again.

Hem, who liked things to be safe and stable, got increasingly frustrated and unhappy. He never got new 'cheese'.

In our lives, we realise that as change happens often, we need to deal with it proactively and positively. *Who Moved My Cheese* reminds us of how to apply this realisation. The story highlights that change is inevitable and that we need to be prepared for it to happen by monitoring our environment. When the time is right we need to adapt and leap into action quickly.

I often see successful organisations applying the principles of *Who Moved My Cheese*.

For example, I recently attended an interview hosted by Singapore's Institute of Banking and Finance (IBF) titled *Emerging stronger from COVID-19 Co-Creating Opportunities for our workforce* in October.

The event was an interview with Mr Tharman Shanmugaratnam, Senior Minister and Coordinating Minister for Social Policies, Chairman of MAS, and National Jobs Council; and Mr Samuel Tsien, Group CEO, OCBC Bank, Vice-Chairman of IBF Council, and Member of National Jobs Council, to discuss the future of jobs, skills, careers, and personal insights on how organisations can transform and develop their talent to meet future challenges.

It was also a discussion on how change is being dealt with in the financial sector.

For me, two quotes from the minister illustrated the application of the *Who Moved My Cheese* principles.

One quote discussed how to change across the financial services industry was being anticipated; Mr Shanmugaratnam stated that the government would,

"Work pre-emptively with employers and with firms. First," to "know what jobs are likely to become redundant and what new jobs are being created." They would then "Work pre-emptively to create new jobs and train people for new jobs."

The second quote addressed the need to be prepared for change by monitoring training requirements and delivering the training requirements quickly.

"We have to customise training a lot more. Through our six-monthly surveys, we are going to be able to get to a very granular level of the nature of the jobs being created, the specific skills required, and then we can look at individuals in the same customised fashion. What do they already have, what is transferable, and what needs to be added to their skills toolkit."

It is this application of the principles that will encourage the continued positive management of change.

CRITICAL SKILLS TO DEVELOP FOR THE FUTURE

Connected with understanding and adapting to change is the need to develop a set of critical skills within ourselves and teams. Tony Wagner is an American educational specialist, a Senior Fellow at the Learning Policy Institute. Tony has interviewed leaders in industry, in education, as well as the armed forces, to identify their thoughts on skills needed by the workforce in the future.

Interestingly, across all sectors and industries, the following skills sets were consistently identified as important areas of educational development for the future

- Critical thinking;
- Collaboration across networks;
- Leading by influence, not authority;
- Agility and adaptability;
- Entrepreneurship;
- Curiosity and imagination;
- Accessing and analysing data; and
- Ability to ask questions.

When I review this list, these skills make sense. In a time of constant change, we will need capabilities that allow us to question, review, adjust, learn, and assess continuously.

Anyone developing these skills will be more than prepared to surf with any of the large waves of change coming their way. ✱

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GETTING TO RAPID-FIRE CREDIT DECISIONING

By Julia Chong

Models to predict the Now.

Banks are no stranger to risk, but some risks are more equal than others.

In Banking Insight's July/August issue, our article, *Simulating Mega Risks of Tomorrow,* covered much of the response to the pandemic, including adjustments and alternatives which banks must consider in their risk modelling as historical analysis breaks down under the weight of scrutiny.

We continue our focus on credit risk, this time on banks' obligations and experimentations in improving the quality and efficiency of credit risk management.

But first, some necessary updates on the regulatory front.

GOAL POST IN SIGHT

Referred to by the market as 'Basel IV CVA', on 8 July 2020, the Basel Committee on Banking Supervision (BCBS) issued its final revisions to the credit valuation adjustment (CVA) risk framework, which is applicable to all derivatives (except those cleared through a qualifying central counterparty) and the fair value of securities financing transactions (SFTs). Its policy paper, *Targeted Revisions to the Credit Valuation Adjustment Risk Framework*, is based on consultations with and feedback from market participants in November 2019 and the proposed amendments align parts of the CVA risk framework with the final market risk standard and capital requirements for bank exposures to central counterparties.

This latest and final round of credit risk adjustments by the supervisory body is aimed at relieving banks' operational burden, incentivising central clearing, and promoting consistency in implementation. With this, the goal post is now in sight. Postponing the deadline for implementation by 12 months, the BCBS has now confirmed go-live on 1 January 2023.

The targeted revisions are summarised below:

- **Reduced risk weights.** This applies to the standardised CVA (SA-CVA) and basic CVA (BA-CVA) calculation approaches. Bear in mind that under CVA, banks must use the basic approach unless they receive approval from their relevant supervisory authority to use the alternative standard approach.
- **Introduction of new index buckets** where banks could, under certain conditions, calculate capital requirements using credit and equity indices directly instead of looking to the underlying constituents. The Committee has agreed to introduce the same new buckets in the:
    - counterparty credit spread risk class;
    - reference credit spread risk class; and
    - equity risk class of the SA-CVA.
- **Revised formula for aggregation of capital requirements** across buckets in the CVA risk framework for better alignment to the market risk framework.
- **Alterations to the scope of CVA risk capital requirements.** Measures include preferential treatment by exempting certain client-cleared derivatives for client exposures and reducing the floor for the margin period of risk for some centrally cleared client derivatives. This brings the CVA more in line with the counterparty credit risk framework.
- **Overall recalibration of the CVA risk framework.** A reduced aggregate multipliers under SA-CVA and a scalar for banks using BA-CVA. The effect is a recalibration of capital requirements for banks.

RISK COVER AT GROUND ZERO

With over nine months of the pandemic behind us, the report card for the financial sector is overall positive. A plus point has been banks' rapid response in speeding up credit decisioning to ensure uninterrupted delivery of essential financial services. Moving forward, what's required is now to test out new approaches to more accurately evaluate or predict creditworthiness (or riskiness) of borrowers.

For this purpose, it helps to have an overview of the current landscape. McKinsey & Co's July 2020 report, *Managing and Monitoring Credit Risk After the Covid-19 Pandemic,* found five major changes to the credit-risk environment for which financial institutions must anticipate in order to minimise further shocks to the ecosystem. We summarise the findings below:

+ Changes in creditworthiness at the sector and subsector level.

Leading financial institutions are beginning to approach underwriting and monitoring with a new configuration of sector analysis, borrower resilience, and high-frequency analytics. A key trend is that leaders are moving relatively quickly from a sector view to a subsector view and finally an obligor view, using real-time data and analytics, which then supports decision-making.

Most banks have developed refined hypotheses about specific subsectors and are approaching (or have already arrived at) an obligor view of risk assessment. The analysis of sectors and subsectors translates into a probability-of-default (PD) shock. One UK bank quantitatively analysed the PD change for each sector by stress-testing the profit and loss of the counterparties on the basis of the expected shock and recovery trajectories for each sector, reassessing the debt repayment ability accordingly. The results proved that the PD shock can vary three or four times in magnitude.

+ Hard to differentiate between borrowers in the same sector or subsector.

The distinctly different profiles recognised by banks within subsectors depend on varying demand patterns, supply chain factors, and market organisation. Much attention has focused on reopening the economy but banks and businesses should also think about horizons: different regions and countries are at different stages of the pandemic and thus reopening at different speeds. Economies that are now mostly open are experiencing trade and supply-chain distortions from lagging former partner economies.

Lenders will need to think through these eventualities and codify perspectives in their analyses. The public-health dimensions of the present crisis led one US bank to develop composite risk scores at the intersection of geography and industry sector, which helped the bank differentiate more clearly among borrowers.

+ Pertinent data on crisis conditions are scarce, lagging, and not fed automatically into decision-making.

Beyond this horizon are approaches using real-time business data in decision-making and advanced analytics to review credit underwriting processes. The transition to these new methods will help banks cope with the present crisis but also serve as a rehearsal for the step change that, in our view, credit risk management will have to make in the coming months and years.

+ Socially responsible collections needed to meet changing customer preferences.

Banks must shift to a customer-assistance interaction model and make it a priority in their digital transformation.

+ A large wave of non-performing exposures is beginning and must be addressed in new ways.

Financial resilience will be determined less by pre-Covid-19 profitability than by indebtedness and liquidity, attributes that will establish a borrower's ability to weather the crisis. Operational flexibility, including the soundness and adaptability of a business model in the new environment, is determined by the cost base and the possibility that it can shrink in line with demand. These factors can be evaluated through transaction data: current account inflows, credit line utilisation, and the evolution of point-of-sale transactions.

The management consultancy advises: "The best banks will keep and expand these practices even after the crisis, to manage credit risk more effectively while better serving clients and helping them return to growth more quickly." The differentiator will be how quick banks can incorporate new and emerging data into its risk evaluation framework. This requires a shift from old style 'forecasting' to dynamic 'nowcasting'.

NOWCASTING

The need to populate credit risk models with current data is acute in this unprecedented crisis as pure reliance on historical data is certainly misleading. This envisions a fundamental and immediate shift from what banks are accustomed to in their credit risk, a move from 'forecasting'

to 'nowcasting'.

The term, which has its origins in meteorological science, describes the economic technique for very short-range forecasting or prediction of the present. Author Alexander Ineichen, in his paper titled *Nowcasting and Financial Wizardry*, defines nowcasting as "the economic discipline of determining a trend or a trend reversal objectively in real time. Nowcasting is fact-based, focuses on the known and knowable, and therefore avoids forecasting. [It] is the basis of a robust decision-making process.

"A 'nowcaster' does not try to predict the future but focuses what is known today, i.e. know now in real-time. Forecasts are an integral part of orthodox asset allocation and are essentially guesswork. In other words, guessing is an integral part of how assets are allocated and risk is taken. There is an alternative; a focus on facts rather than forecasts."

To correctly apply nowcasting, non-traditional or alternative sources of data ('alt data') must be sourced and used by financial institutions to innovate and remodel within a period of weeks instead of the customary months or years.

What is alt data and how does it enhance credit risk modelling? Traditional data is broadly understood as information assembled and managed by official sources such as credit reporting or rating agencies, government sources, and internal reports. Information originating outside of this sphere is considered to be alt data.

But do not be misled. Incorporating alternative sources of information in credit risk models isn't a radical, new idea.

For more than a decade, international lenders and regulators have advocated that banks use alt data to serve the 'unbanked' or 'underbanked' in our midst. The World Bank, the International Monetary Fund, and national regulators have encouraged banks to refine their credit assessments and scoring methodology to ensure the uninterrupted provision of credit to the 'unbanked' and 'underbanked', i.e. people and businesses who have no history with credit reporting companies (they're called 'credit invisibles') or carry 'thin' credit files (known as 'credit unscorables', i.e. individuals with less than three sources of payment information or trade lines).

As some of today's corporate behemoths – airlines, tourism, luxury retail – devolve to similar standing as 'undesirables' in our economy and are faced with the real possibility of being labelled 'unbankable', typical risk models using conventional data sources have become obsolete.

The ability to speedily determine creditworthiness, PD, and expected credit losses – reasons for the growing adoption of nowcasting – is contingent upon access to and incorporation of alt data such as:

- **Resilience scores:** In addition to conventional credit scoring/rating/ranking – which impacts a loan's structure, drawdown conditions, interest rate, tenure, margin of financing – lenders are today also relying on resilience scores. This is an index that ranks the ability to withstand economic disruption like Covid-19 and reflects tightening credit standards. A lower resilience score is better and is achieved by evaluating using longer-term metrics than credit scoring or rating, such as less frequent credit inquiries or applications, more experience managing credit, lower total revolving balances, and fewer active accounts.
- **Behavioural attributes:** For starters, look out for data beyond account balances and credit scores/ratings. Creative new sources of data include timeliness of bill payments (rent, utilities); volume of e-money transfers; smartphone activity; number of packages shipped a month; online reviews on Yelp, TripAdvisor; and social media feeds. Remediation clients will hopefully eventually return to the black soon, but in the meantime, lending decisions based on alt data can aid market liquidity whilst encouraging clients to cultivate good credit habits, which lead to more favourable loan terms down the road. Note that accumulation or aggregation of such data in the risk model must adhere strictly to privacy law such as General Data Protection Regulation and equivalents.
- **Machine learning predictive models.** These embed multiple forms of analytics into the credit evaluation process and automate the decision logic to deliver near-real-time, highly relevant assessments, especially in high-volume environments. Algorithms and technologies such as distributed ledgers sift through high-frequency data to uncover anomalies and flag potential risk of money laundering. Furthermore, investing in a self-learning model can take fraud detection to the next level by minimising the number of 'false positives'. Additionally, new solutions could also offer integration with other areas of risk and finance, such as capital calculation and IFRS 9, creating more integrated and seamless reporting.

Ultimately, the best banks will leverage on the lessons endured throughout this crisis and constantly expand and reinvent practices. This requires courage as well as creativity. Those which do so will reap the rewards of cheaper credit acquisitions, better risk management, happier customers, and faster growth trajectories. ✱

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FUTURE-PROOFING YOUR RISK MANAGEMENT FUNCTION

By Dr Eric H.Y. Koh

Key requirements for a comprehensive and sustainable competency development journey.

Banks are confronted with a limited risk management talent pool. One way of future-proofing your risk management function comprehensively and sustainably is by implementing a proposed integrated approach to competency development.

THE CHALLENGE

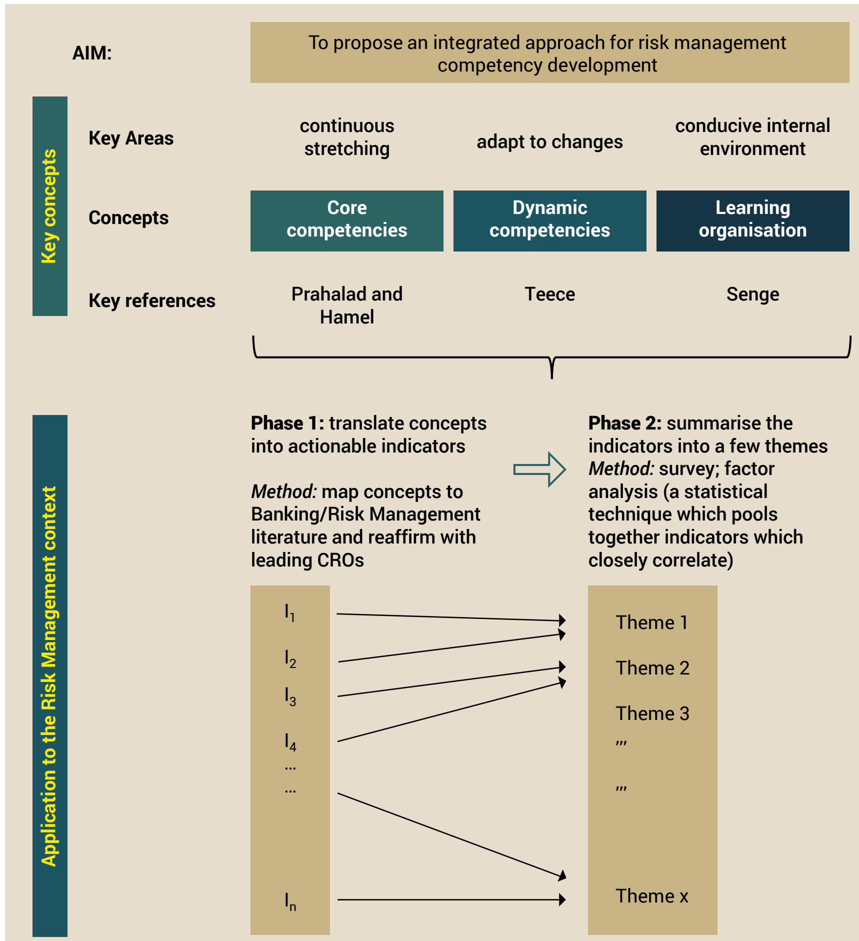
The 2008 global financial crisis (GFC) had severely dented both the financials and also the image of many global banks. Who could blame US taxpayers for being infuriated with the US$475 billion bailout? Ten years post-GFC, the pain continues as regulators worldwide penalised banks some US$375 billion for misconducts such as money laundering, securities fraud and London Inter-bank Offered Rate rigging. The crisis and these embarrassing penalties point to a fundamental problem: risk management weaknesses.

In order to address this problem, banks may resort to poaching risk management professionals, engaging consultants, or building better systems. Such actions may be necessary but they are not the panacea to the ongoing fundamental problem. Such actions, especially when taken in isolation, may neither be comprehensive nor sustainable. For instance, if you poach from your competitors, they may one day poach your professionals too and the musical chair continues with ever-increasing salaries but not necessarily better talents. Besides, it is pointless to hire professionals from another bank if they are not able or willing to integrate into your bank.

Some may suggest revisiting staff qualifications at various seniority levels. Others may suggest looking at staff retention. While these are important, publications on such matters abound. What seems lacking, however, is discussions on the key requirements for a comprehensive and sustainable competency development journey. This

Some may suggest **REVISITING STAFF QUALIFICATIONS** at various seniority levels. Others may suggest looking at staff retention. While these are important, publications on such matters abound.

Figure 1: The overall aim and work done



article aims to propose an integrated framework that provides an overarching yet granular view of these key competency development requirements.

THE IDEA

Let's consider the Japanese badminton team's inspiring success. In a game dominated by China and Indonesia, Japan hardly featured until their stunning 2014 maiden Thomas Cup victory. They continue to surge ahead as Japan has now won the Uber Cup, World Cup and Olympics too. Although their players had traditionally been skilful, their prior achievements seem inhibited; they were not producing world-beaters.

Some other teams may have produced world junior champions but their momentum did not continue to the senior league. Some teams, on the other hand, seem to plateau or even deteriorate. In other words, these teams had a good head start or had already peaked but could not sustain their success. Japan, however, had none of these. Among the ingredients for Japan's success story is the stretching of their players' abilities through infusion of new external techniques by a great Korean coach, Park Joo Bong. Besides, there is a conducive learning environment where the authorities give Park sufficient latitude and both players and coaches share the same aspiration. This inspiring success story provides hope and lessons, even for banks. These key broad ingredients – stretching the players' abilities, the ability to adjust to dynamic externalities, and a conducive learning environment – correspond to three popular competency concepts, namely core competencies, dynamic competencies, and the learning organisation.

WORK DONE

Most prior studies examine each concept in isolation. This article, however, pools together these three concepts because they complement one another. Pooling together the concepts provides a more potent tool for formulating a more comprehensive competency development journey. Besides, most prior studies remain conceptual; they do not translate the concepts into actionable or operationalised indicators, especially to an intangible service sector such as banking.

Figure 1 illustrates the work done and intended output through a two-phased approach. In Phase 1, we translate the concepts into actionable indicators through literature reviews and interviews with leading Chief Risk Officers (CROs). In Phase 2, we study the feasibility of summarising the indicators into a few themes according to the indicators' statistical correlation. Towards this end, we obtained inputs from 135 risk management professionals in a survey. The survey sought to obtain their views as to the extent to which their banks implemented these indicators. We applied factor analysis to identify the indicators which closely correlate and hence, form the respective unique themes.

OUTPUT/DISCUSSION

Table 1 summarises the output in terms of the five themes and also their respective constituent actionable indicators.

+ **Theme 1: Active learning**
  This calls for a right mindset of wanting to learn meaningfully, intentionally, and willingly rather than blindly or grudgingly following routines or orders. It comprises eight indicators of which we will discuss three. First, having a right risk culture which upholds risk principles is important to foster competency development. Conversely, a bank which sees risk merely as a necessary evil would not have a conducive environment for risk management competency development. Second, people learn more effectively through hands-on experience from their previous experience. For instance, people who have prior experience in loan recovery, trading, or sales may be able to better sense and understand the potential pitfalls. Likewise, it may be good for risk management staff to be seconded to other functions to gain valuable insights. Third, we also need to actively relook at whether portions of the current competency profiles are relevant and up-to-date. In fact, we should also take drastic steps of removing irrelevant competencies so as to avoid being caught in a competency trap.

There is a **CONDUCIVE LEARNING ENVIRONMENT** where the authorities give Park sufficient latitude and both players and coaches share the same aspiration. This inspiring success story provides hope and lessons, even for banks.

THEME	CONSTITUENT ACTIONABLE INDICATORS
T1. Active learning	1. Risk awareness culture
	2. Past experiences in other functions
	3. Revisit relevance of competency profiles
	4. Induction
	5. Business unit partners
	6. Build competencies in new risk management techniques
	7. Learn by developing own risk models
	8. Build new relevant competencies
T2. In the bank's interest	9. Future scenarios
	10. Align goals
	11. Cross-functional team discussions
T3. Proactive	12. Aware of new risk management techniques
	13. Keep abreast of regulatory developments
	14. Proactive self-development
T4. Stretch	15. Leverage quantitative skills
	16. External value chains
T5. Broader perspective	17. Comprehensive view
	18. Enterprise-wide risk management

Table 1: Key themes and constituent indicators

+ **Theme 2: In the bank's interest**
  This calls for a right heart. Any competency development initiative will fail if the staff members pursue their dysfunctional or selfish motives. First, staff members should engage in constructive debates to ponder upon future scenarios and prepare for the risk management ramifications. Second, the goals of the risk management function and its business partners must be aligned to the bigger picture of the bank's interests. If their goals are not aligned, competency development efforts would be ineffective Finally, having objective discussions among staff members from different functions help to continuously widen their perspectives and sharpen their competencies.

+ **Theme 3: Proactive**
  This calls for being prepared ahead of time and comprises three indicators. First, staff members need to be proactively aware of new emerging techniques rather than being told of such developments. Second, they should also keep abreast with risk-related regulatory developments.

Finally, they should be self-driven to develop themselves rather than waiting to be sent to training programmes. A risk management function should encourage its staff to be proactive so as to continuously develop their competencies.

+ **Theme 4: Stretch**
  One should also stretch beyond the current competency levels. For instance, instead of looking only at the conventional disciplines of banking and finance, a bank could recruit some staff members with strong quantitative backgrounds such as mathematics or engineering. Given the right orientation, such members would help enhance the risk management competencies in complex multidisciplinary areas such as derivatives and structured products. Likewise, besides discussing internally, the risk management function can also work with relevant external parties so as to be more sensitive to the rapid changes and to continuously develop competencies. These parties may include customers, suppliers, or even regulators.

+ **Theme 5: Broader perspective**
  This calls for going beyond a narrow silo view. Instead, one should look beyond the surface and consider how events and developments interact or even have lurking risk implications. It also calls for viewing risk from an enterprise-wide or integrated perspective rather than being in separate buckets of risk categories such as credit, market, or operational risks. Indeed, risk management professionals should look beyond their respective domains and consider the potential interrelationships with other risk categories.

This article discussed the **PROBLEM OF RISK MANAGEMENT WEAKNESSES** in banks and proposed an integrated approach to competency development. It pooled together three concepts and identified the actionable indicators which may be summarised into five themes.

CONCLUSION

This article discussed the problem of risk management weaknesses in banks and proposed an integrated approach to competency development. It pooled together three concepts and identified the actionable indicators which may be summarised into five themes. The proposed framework provides a more comprehensive and sustainable approach towards competency development. This is because it looks at three aspects that facilitate competency development, namely stretching competencies, adapting to dynamic externalities, and a conducive environment for continuous bank-wide learning. It is overarching because it proposes a broad five-theme approach. This provides a practical tool to facilitate regular updating and brainstorming sessions. Concomitantly, it is also granular because it is easily expandable into the 18 constituent actionable indicators.

Just as seen in the case of Japan's badminton team's inspiring success, the proposed approach may facilitate a bank's risk management competency development journey to greater heights in a more comprehensive and sustainable manner. ✱

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