bankinginsight

IDEAS FOR LEADERS
DECEMBER 2011

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PROFESSIONALISING OUR BANKING PROFESSION

WHAT LIES AHEAD

HOW BANKS CAN HELP THE PLANET

How banks can become more sustainable and green the earth in the process.

CHALLENGES FOR CEOs

SOCIAL MEDIA TRENDS FOR BANKING

THE WAY FORWARD

The Challenges Facing the Banking and Finance Industry

Tan Sri Azman Hashim

REFORMS, ETHICS AND EDUCATION IN BANKS

BROADENING *SUKUK* HORIZONS

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Institute *of* Bankers Malaysia
35880 P

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GLOBAL CHALLENGES & LOCAL OPPORTUNITIES

SHANGRI-LA HOTEL, KUALA LUMPUR • 8 - 9 May 2012

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ENHANCING RESPONSIBILITY

2011 MIGHT BE DRAWING TO A CLOSE, but there is scant closure for controversial issues that dominated headlines during the year.

The chasm between stakeholders and banks remains wide and the backlash against global banks in developed markets hasn't eroded, judging by the ire of demonstrators in events like Occupy Wall Street, which sparked copycat protests from London to Madrid. While the language of protests might differ from city to city, there is an underlying message that is unanimous – apart from demonstrating their fury with beleaguered ruling governments, the public wants big corporates, particularly financial institutions that are the perceived villains of the 2008 Global Financial Crisis (GFC), to be more responsible and accountable. They want behavioural change, from the self-centred, self-enriching and self-rewarding mentality that still pervades elite corporate circles to a more altruistic and inclusive mindset that empathises with public pain.

While Malaysia – like other Asian real economies - has been largely insulated from the contagion of the GFC and ongoing sovereign debt crisis, there is an urgent need for the banking sector to transform itself in order to participate fully in the idealised vision of the fully-developed and mature 2020 economy conceptualised by the government of Prime Minister Dato' Sri Mohd Najib Tun Abdul Razak.

Reflecting the concerns of the moment, transformation, governance, responsibility, inclusiveness and education are the core themes that run through this issue of *Banking Insight,* as expounded by a diverse panel of thought leaders. Playing devil's advocate, Graeme Maxton, economist and author of the book "The End of Progress: How Modern Economics Has Failed Us", argues that the growth-driven economic model is obsolete and underscores the need for a new model to measure progress that is just and fair and fulfils the hopes and dreams of all humanity, not just the privileged rich. Over in the *Governance* section, Professor Ted Gardener of the top-ranked *Bangor Business School, Bangor University* is urging the revamping of a post-crisis system of governance that is tailored to meet the unique business models of banks as well as the environments in which they operate. Apart from reworking corporate governance, he also advocates upgrading personal governance, such as the widening of the duty of care and fiduciary responsibility for bank directors and senior personnel, given that their roles have such great impact on the financial and economic well-being of ordinary people.

How can personal governance be upgraded? That's where professional education and training offered by institutes like IBBM play a vital role in developing the calibre and expertise of professional bankers and in reforming the benchmarks and standards by which to measure their performance and behaviour. There may also be a case for holding professional bankers to higher fiduciary standards since they are in the business of providing financial advisory, oftentimes to clients who are less than well-versed in sophisticated financial products, such as – ahem - derivative instruments. Read all about these proposals in our section on *Thought Leadership*.

Meanwhile, since 2012 is right around the corner, it's timely to assess the opportunities and challenges that lie ahead for the banking sector and M&As, a segment which shows no sign of fizzling out anytime soon as businesses strive to create even more value by amalgamation. There could also be value in addressing the financing needs of microbusinesses and microentrepreneurs in efforts to elevate marginalised segments of society, says distinguished banker Tan Sri Azman Hashim, Chairman of the AmBank Group and Chairman, IBBM in our cover story this issue. Would banks have to re-evaluate their business models to address the micro and financial inclusion agenda propounded by Bank Negara Malaysia, in the process becoming more socially responsible and beneficial to all segments of society?

The writing on the wall is patent – change is unavoidable regardless of location. We hope this issue leaves you with plenty of food for thought and new insights into the currents of banking and finance for the upcoming new year. On that note, we wish all our readers a Merry Christmas and a Happy New Year. May your 2012 be full of prosperity! ✱

Hope you have a fruitful read.

THE EDITOR

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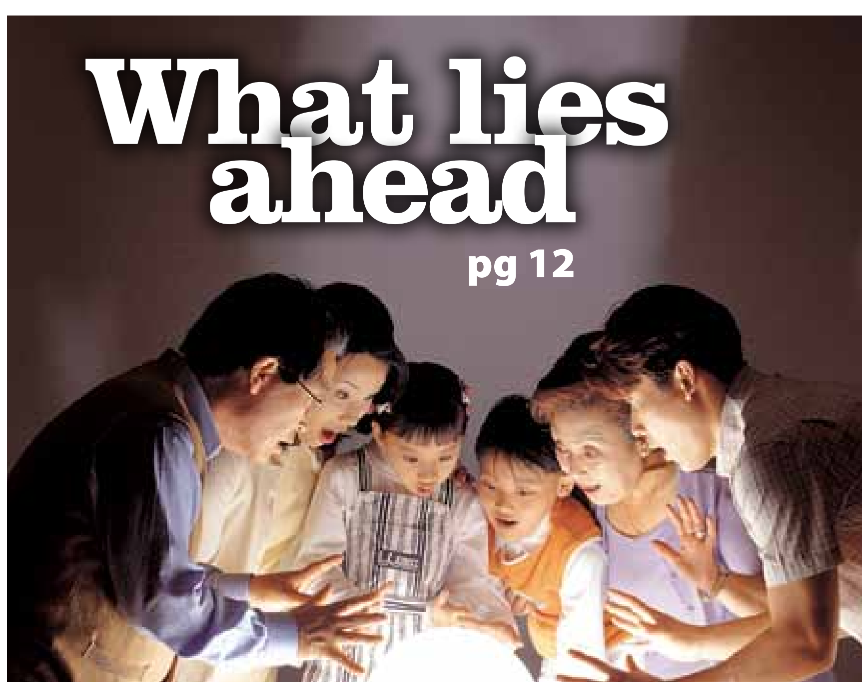

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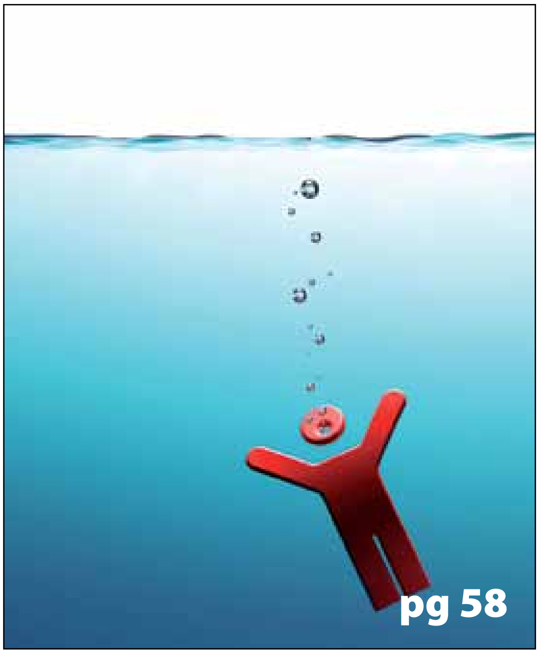

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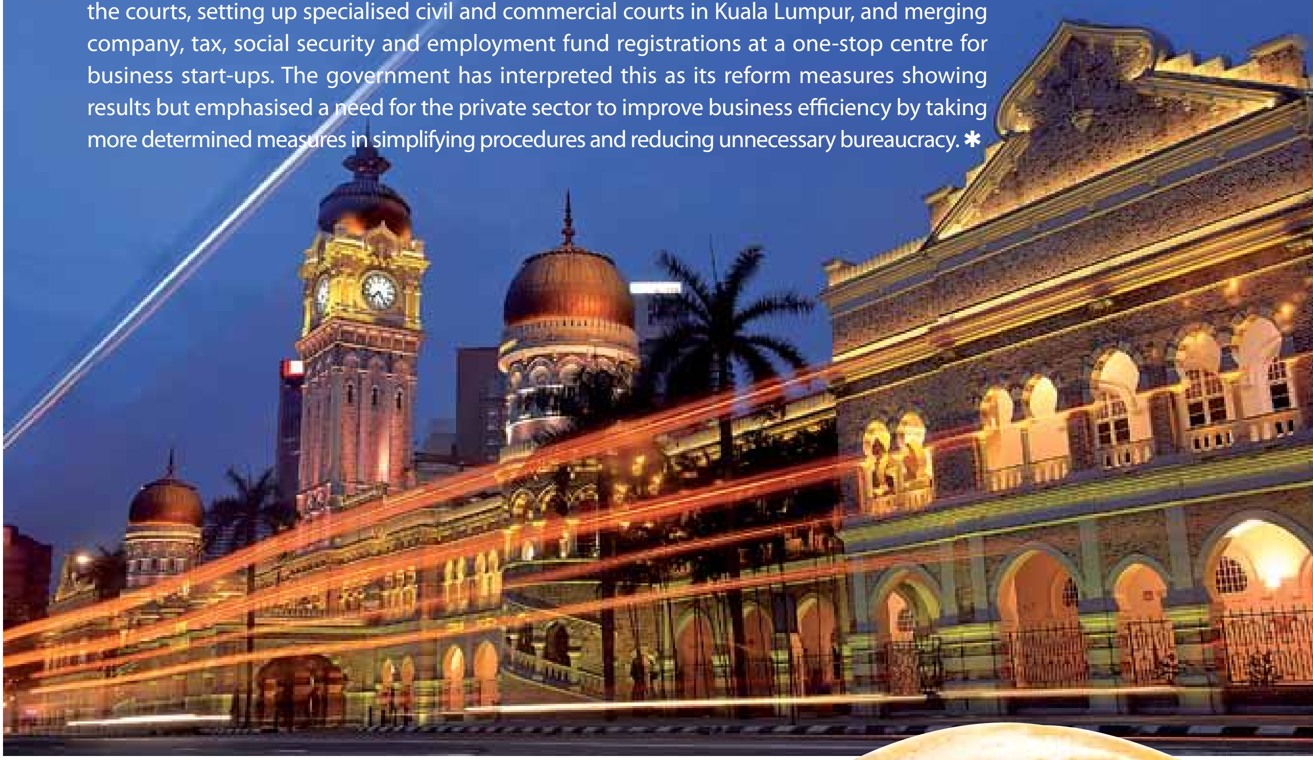
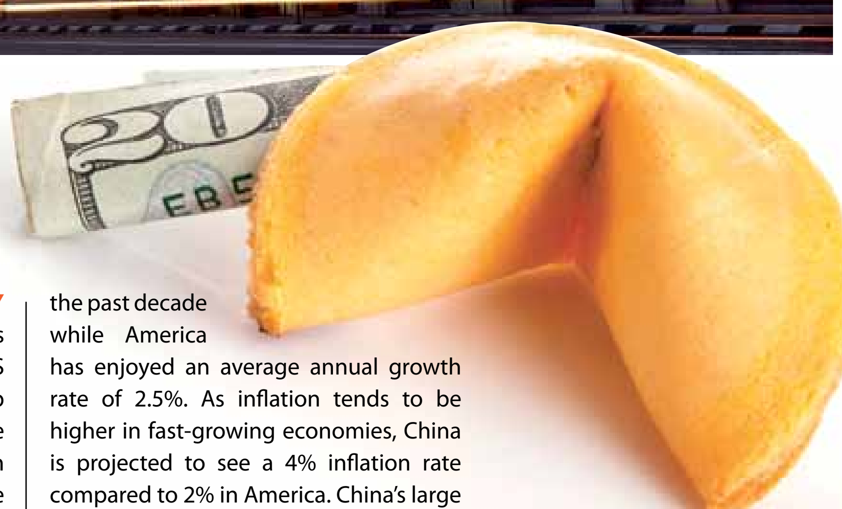
Efficient

More determined measures in simplifying procedures and reducing unnecessary bureaucracy.

MALAYSIA GETS BETTER AT BUSINESS

MALAYSIA HAS MOVED UP five notches to 18th place in the World Bank Doing Business Report 2012 putting it ahead of developed economies such as Germany, Japan, Taiwan and Switzerland. The report highlighted the lead Malaysia took in introducing electronic filing in the courts, setting up specialised civil and commercial courts in Kuala Lumpur, and merging company, tax, social security and employment fund registrations at a one-stop centre for business start-ups. The government has interpreted this as its reform measures showing results but emphasised a need for the private sector to improve business efficiency by taking more determined measures in simplifying procedures and reducing unnecessary bureaucracy. ✱





CHINA vs THE US

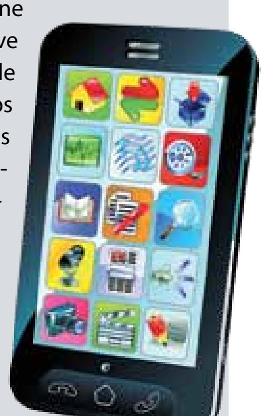
THE INTERNATIONAL MONETARY FUND (IMF) has forecasted that China's economy will likely overtake the US economy by 2016. How quickly that gap is closed, however, depends on three variables: the speed of real GDP growth in China and America respectively, the inflation gap between both economies, and the rate of the yuan's rise or fall against the dollar. Number crunching has indicated that China's economy has grown by an average of more than 10% a year over the past decade while America has enjoyed an average annual growth rate of 2.5%. As inflation tends to be higher in fast-growing economies, China is projected to see a 4% inflation rate compared to 2% in America. China's large current-account surplus and America's big deficit also suggest that the yuan will become stronger and the dollar weaker. If all this comes to pass, China's economy will be bigger than America's by 2020. ✱

RAISING THE BAR

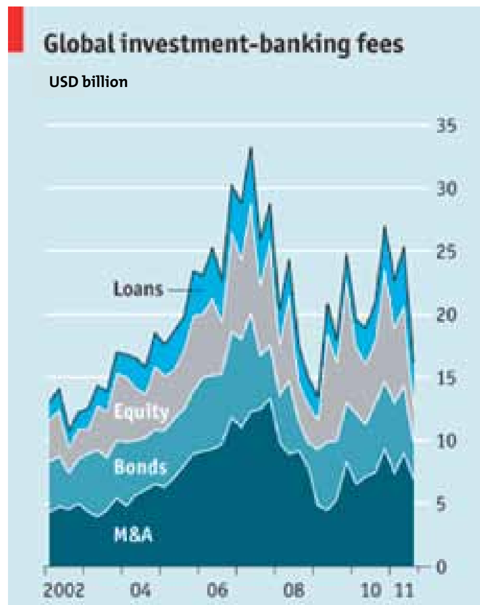
THE EUROPEAN BANKING AUTHORITY (EBA) has declared that European banks must raise an additional €106bn in fresh capital by June 2012 to meet new capital requirements under a deal to tackle the Eurozone debt crisis. These measures form part of a broader package aimed at addressing the current situation in the EU by restoring stability and confidence in the markets. The EBA said that 70 banks were tested with Spanish banks needing €26.2bn, Italian banks €14.8bn and German banks €5.2bn. The UK banks however won't be required to raise fresh capital. The banks will have to submit their plans for raising the money to national supervisors by 25 December 2011. According to EBA, the building of these buffers will allow banks to withstand a range of shocks while still being able to maintain an adequate capital level. ✱

BANKING ON THE RUN

A RECENT STUDY found that 32.5 million Americans accessed mobile banking information on their devices at the end of June, representing 13.9% of all mobile users. The study conducted by *comScore* also revealed that 12.7 million mobile users reported using banking apps, showing a notable increase of 45% from end-2010. *comScore* noted that investments in mobile made by financial services institutions together with continued growth in smartphone adoption have had a positive effect on the use of mobile financial services. New apps and mobile-enhanced sites have made it easier for people to access financial information not just through their mobiles but also on tablets and other popular web-enabled connected devices. ✱



JUMP IN GLOBAL INVESTMENT BANKING FEES



Source: Thomson Reuters

THE FIRST NINE MONTHS OF 2011 saw global fees for investment banking services climb USD64.2bn (8%) compared to the same period a year earlier, according to financial-data provider *Thomson Reuters*. JPMorgan remains at the top of the table earning USD4.3bn in fees since the beginning of the year, an increase of 12% compared to a year earlier. ✱

FULL STEAM AHEAD FOR ISLAMIC FINANCE

ACCORDING TO THE second annual Global Islamic Finance Report 2011, the Islamic finance industry is valued at USD1.14 trillion and is growing at a rate of 10%. The industry is gradually building the depth, quality and quantity of its product portfolio and entering into new, previously unfounded fields in the financial markets. There are new *Shariah*-compliant derivatives, innovations in asset and wealth management, improvements in efficiency of banking and the creation of products which satisfy regulatory requirements. But challenges still exist. Generally, bankers and regulatory systems are failing to consider the subtle nuances of Islamic finance law, and expertise in human resources is limited. A perception problem still exists with many potential consumers adopting a cautious approach but this is to be expected and will take a few years to resolve. ✱

The way forward

DISTINGUISHED BANKER TAN SRI AZMAN HASHIM, Chairman of the AmBank Group and Chairman of the Institute *of* Bankers Malaysia (IBBM) shares some insights into the people capacity challenges facing the banking and finance industry.

If there is one thing we can be certain of post-2008, it's the volatility and the speed of change taking place in the banking space.

Swings in the equities and commodities markets, and US and Eurozone debt crises that hit media headlines have stretched political leaders and policymakers to the limit. "It is evident that the world financial environment is going through a real crisis today. The current financial architecture needs major innovative changes because the business as usual is obviously not working too well," said Tan Sri Azman Hashim, Chairman of the AmBank Group and Chairman of the Institute *of* Bankers Malaysia.

To manage the unpredictable economic landscape, the domestic banks need to protect themselves against the adverse implications of the prevailing weakness in the developed economies. "Because the world now is so flat and globalised Malaysia needs to be on its toes. Although in many ways we are shielded, we cannot run away from the contagion impact of what is happening in the US and in Europe. For example, today we can see stockmarkets dipping and this would affect the confidence and sentiments among the investors in our own markets and Asian markets. We have to be alert and we have to prepare ourselves and strengthen ourselves to be able to cope with future challenges."

BUILDING UP TALENT

One critical solution to strengthening ourselves is to focus on building the quality of talent pipeline. Malaysia has signalled that it wants to make the transition to a matured high-income economy and with services as its backbone. A service-oriented economy can only succeed if it has sufficient talented and skilled people at its disposal. A key component of the services economy would be the banking and finance industry.

> **"The need to increase the skill capacity of the people at middle and senior levels is very urgent. This is where institutions like IBBM have a very critical role; we have to deliver quality training at a high level."**

"The banking and finance industry in Malaysia has been growing very strongly over the years and now also, with the advent of many new international banks and Islamic banks into the scene," said Azman. While liberalisation has made the banking sector very competitive, it has also placed great strain on the existing talent pool. "There is quite a great shortage of experienced and skilled banking professionals especially at the senior and middle management level. This is creating quite a problem.

Another problem is the inadequacy of the talent reservoir to help drive the global ambitions of the banks. "People are moving upwards from institution to institution within the same year and rapidly increasing their remuneration without an equivalent improvement in knowledge and skills."

To address this, the banking and finance sector has to invest in quality education and training that are of world-class standards. "The need to increase the skill capacity of the people at middle and senior levels is very urgent. This is where institutions like IBBM have a very critical role; we have to deliver quality training at a high level."

Continuing liberalisation is also placing pressure on training providers to raise its stakes. "The banking sector in Malaysia has international banks participating, and they require world-class standards. Therefore, IBBM has to ensure its courses and training facilitation will be ahead of the learning curve to ensure we have bankers of world quality."

Training providers must also bridge the expectations gap. "IBBM and other training institutions in Malaysia - including universities - need to have a close rapport with the industry to know their needs and requirements exactly so that training courses will be designed to suit the marketplace," Azman elaborated.

The flipside of nurturing world-class and quality talent is excellent portability and mobility. Since Malaysian bankers are highly regarded, their skills and qualifications are portable. "The skills required in the banking and finance sector is now a world-wide phenomenon. You find Malaysians are being attracted to work in many countries overseas, such as Singapore, Hong Kong, the UK, and China. This is because our standards are international and therefore the marketplace for qualified Malaysians is now global."

IBBM has to ensure its courses and training facilitation will be ahead of the learning curve to ensure we have bankers of world quality.

Financial inclusivity and people challenges

Under the country's economic transformation programme being promulgated by the government, the private sector is urged to play a larger role as partners in nation-building. Cognisant of their corporate responsibility, banks have always and continue to be active in terms of developing capabilities and capacities for the transition, noted Azman.

Specifically, since talent is a critical component of moving to a high-income developed economy, "we are helping to finance the relevant infrastructure for building talent such as universities and colleges and funding talent and scholarship schemes where we train graduates, such as FSTEP (Financial Sector Talent Enrichment Programme). These are part of the efforts of the banking sector to build up talent to meet the needs of developing the economy and to try and do as much as we can," he explained.

Meanwhile, Azman argued that a higher priority should be placed on microfinance, which could drive the nation's goals of improving financial inclusion and empowering people economically, especially the disenfranchised and disadvantaged. "We are pushing microfinance at the APEC agenda because microfinance is very vital especially to developing economies, where most of their business consists of microfinance. Microfinance affects the most number of people and takes the least amount of money in terms of effectiveness and it is really the backbone of the economy. Microfinance goes into small businesses and business goes up and gets more people involved in productive activities."

Microfinance affects the most number of people and takes the least amount of money in terms of effectiveness and it is really the backbone of the economy.

"Micro businesses will get off the ground when you give them the support. Track records of various microfinance initiatives in many countries show a good record of repayments."

At the institutional level, changes may also have to be made to accommodate microfinance initiatives. Azman is pleased to note that ABAC (APEC Business Advisory Council) has agreed to convert the traditional SME definition to SMME or "small, medium and micro enterprises" to ensure that microfinance needs are not forgotten.

Azman also recommends setting up dedicated agencies or special departments within financial institutions that are differently staffed to handle microfinance. "Microfinance requires a more entrepreneurial type of thinking, as opposed to banks which have a different mindset." Perhaps a dedicated microfinance bank with a more entrepreneurial mindset is needed in order to drive the sector, he mused. ✱

■ Reporting by the *Banking Insight* Editorial Team.

What lies ahead

GIVEN THE VOLATILITY OF THE GLOBAL FINANCIAL LANDSCAPE, IT IS HARDLY SURPRISING THAT CRYSTAL BALL GAZING IS LESS THAN PERFECT AND IT IS DIFFICULT TO PREDICT UPCOMING DEVELOPMENTS. NEVERTHELESS, *BANKING INSIGHT* ASKED TENGKU ZAFRUL TENGKU ABDUL AZIZ, CHIEF EXECUTIVE OFFICER, MAYBANK INVESTMENT BANK BHD TO SHARE HIS THOUGHTS ON WHAT LIES AHEAD FOR THE BANKING AND FINANCIAL SECTOR.

Q What are the major trends/developments that you think will impact the Malaysian banking sector going forward?

A We are cautious in light of volatility on the external front. Amid expectations of slower economic growth next year coupled with the downtrend in capital markets which will impact non-interest income, our research team has cut banking loan and earnings forecasts across the sector. There is, by our estimates, a lag of about six months between loan growth and GDP growth, with the former playing catch-up to the latter. We maintain our industry loan growth forecast of 12.4% for 2011, but lowered loan growth forecast to 9.4% for 2012. Early this year, we were looking at loan growth of 12.4% for 2011 and 11.5% for 2012. While we continue to expect growth support from ETP (Economic Transformation Programme)-related loan demand, we do expect consumer and SME lending to taper off.

Slower loan growth aside, our research team has also cut non-interest income (NII) forecasts, particularly in respect of investment and stockbroking-related income. NII accounted for an average 29% of total banking sector group income in 2010 and we expect this percentage to hold up in 2011. With the cut in NII estimates, we expect NII to make up a lower 26% of total income in 2012, and 25% in 2013. Cumulatively, our research team expects net profit for the Top 6 banks to grow by just 4.3% in 2012, down from an earlier forecast of 9.9%. We forecast slightly faster growth of 8.7% in 2013.

What has stood out is that while capital markets have been volatile, business has been as usual at financial institutions, and loan demand from both consumers and corporates has continued to be robust. This is borne out by the industry statistics for August which show no let-up in loan growth.

Industry loan growth is still strong. Loan growth gathered momentum again in August, up 13.3% year-on-year (YoY) from 12.8% in July. Household loan growth was stable at 12.7% YoY but non-household lending rose 14% YoY from 13% YoY in July.

Tengku Zafrul Tengku Abdul Aziz

Q How are you reshaping strategy and restructuring your business model in response to these trends?

A Our recent acquisition of Kim Eng Holdings, a regional stockbroker and investment banking outfit, has allowed us to expand our services regionally and globally. Where previously we had to deal with some limitations; such as the lack of investment banking licenses and capabilities outside Malaysia for Maybank IB, and a limited balance sheet for Kim Eng, the merger has now made it possible for us to reach more clients and to offer investment banking services regionally. With our integration, we are now able to leverage on each other's strengths and capabilities to grow rapidly despite the current economic environment.

We're moving forward, transforming from a domestic-focused local bank to operating on a global platform with a full suite of products to offer our clients. We now have a regional talent pool which we can deploy and share amongst us. Previously, hiring would depend on what that particular country needed but pooling our talents and resources means that we are running more cost-efficiently while giving our talents more exposure, better personal development and allowing us to have deeper expertise. We build our regional talent pool to develop talent and build regional know-how through knowledge sharing and talent mobility.

Technology in our industry is a must and we cannot compete without it; it is a basic requirement. We're upgrading our systems and rolling out regional support functions, systems and platforms. Technology enables us to seamlessly service our clients globally and we're constantly looking for ways to make things simpler and more efficient. A good example is the mobile trading application that we will be launching in Malaysia in the near future.

Q Are there any bright spots/prospects given the gloomy economic outlook?

A From a banking perspective, Malaysia's banking system is healthy given the robust core and risk weighted capital ratios of 12.7% and 14.8% respectively, low net NPL ratio of 2%, and 96% loan-loss coverage. Amid the worries about the economic fallout and systemic risk to the financial sector from the worsening Eurozone sovereign debt crisis and weak outlook for the US, the strong balance sheet of the local banking system that has been in place as a result of the sector's restructuring and regulatory enhancement post-1998 crisis provides a structural buffer to the economy. The cyclical buffer comes from macroeconomic flexibility in terms of the ability to adjust monetary policy and fiscal policy to support domestic demand in the face of external uncertainties. Bank Negara Malaysia (BNM) has already halted the normalisation of interest rate by keeping the benchmark Overnight Policy Rate (OPR) steady so far in 2H 2011 and Budget 2012 is very much supportive of the domestic economy, especially consumer spending. In addition, the rollout of infrastructure and investment projects under the ETP should provide additional support to the economy via investment expenditure. Growing importance of intra-regional trade and investment flows also helps to minimise the downsides to such flows with US and Europe.

Q Do you anticipate any banking regulatory reforms/amendments that might change the playing field, especially with regards to the upcoming Malaysian Financial Sector Masterplan?

A It has been a decade since the 10-year Financial Sector Masterplan (FSMP) was introduced in 2001 and the journey continues with the expected unveiling of the 2nd Financial Sector Masterplan (FSMP2). Liberalisation of the domestic financial sector was a key emphasis in the FSMP and we expect it to be an ongoing theme in FSMP2, thus keeping the M&A theme in play.

Previous liberalisation measures

One of the primary thrusts of the FSMP was the liberalisation of the financial sector, and this was further augmented in 2009 with the introduction of the following measures:

- The proposed issue of up to five new licences for foreign commercial banks, two for Islamic banks with a paid-up capital of at least USD1bn and two new family *takaful* licences;
- An increase in foreign equity limits in domestic insurance/*takaful*, investment banks and Islamic banks to 70% (from 49%), and
- Greater operational flexibility for locally-incorporated foreign commercial banks, mainly in branch openings.

Takaful licences have been issued. Given strong applications for the family *takaful* licences, Bank Negara had in September 2010 awarded four new licences instead of two, to:

- American International Assurance (70%) and Alliance Bank (30%)
- AMMB Holdings (70%) and Friends Provident Group (30%)
- ING Management (60%), Public Bank (20%) and Public Islamic Bank (20%)
- The Great Eastern Life Assurance Company (70%) and Koperasi Angkatan Tentera Malaysia (30%)

Islamic banking liberalisation has been very rapid. From just two Islamic banks in 2001 (Bank Islam and Bank Muamalat), there are now 22, of which 11 are foreign – six are Islamic banks and five are international Islamic banks that are involved in non-RM transactions.

Commercial banking licences have been awarded. The five licences have since been awarded to BNP Paribas, Mizuho Corporate Bank, National Bank of Abu Dhabi, PT Bank Mandiri and Sumitomo Mitsui Banking Corporation. This is on top of a licence issued to Industrial & Commercial Bank of China in 2009 and another in 2010 to a locally incorporated company of Bank of Baroda (40%), Indian Overseas Bank (35%) and Andhra Bank (25%).

Islamic banking liberalisation has been very rapid. From just two Islamic banks in 2001 (Bank Islam and Bank Muamalat), there are now 22, of which 11 are foreign – six are Islamic banks and five are international Islamic banks that are involved in non-RM transactions. The recipients (with a paid-up capital of at least USD1bn) of the two Islamic banking licences are expected to be announced this year.

Liberalising stockbroking and wealth/asset management

EPP (Entry Point Project) 1 of the ETP talks about accelerating the liberalisation of the stockbroking industry to strengthen the intermediary base. EPP 7, meanwhile, expands on the need to attract the global top 10 wealth management institutions to set up operations in Malaysia. One of the action plans under EPP 8 is to encourage foreign fund management companies to set up operations in Malaysia with at least six employees and to match foreign capital on a one-to-one basis within the first three years. In return, the total GLIC (government-linked investment company) mandates to external fund managers has risen from 5% to 15% of assets under management (AuM); each mandate being sufficiently attractive in size at RM1bn to RM2bn.

Q Expect more M&As?

A Liberalisation provides fodder for M&As especially since this would result in increased competition in an already competitive landscape. In an otherwise lacklustre operating environment this year, the Hong Leong Bank-EON Bank merger has created excitement and value creation. Admittedly, that the Maybank/CIMB and RHB Capital merger has fallen through is a major dampener. But merger talks have since returned with RHB Capital and OSK in the limelight presently, via a share transfer option.

Q Possible increase in ANZ's stake?

A We expect foreign shareholding liberalisation in local banks to be few and far between, especially since Bank Negara Governor Tan Sri Zeti has emphasised that strategic foreign participation in local banks will stay at 30% and that domestic banks will still be largely locally-owned to ensure that they maintain a financial inclusion policy. We nevertheless do not rule out an increase in ANZ's stake in AMMB Holdings to 49% from 23.8% presently.

Q Strict adherence to Section 46 of BAFIA?

A One of the recommendations of the FSMP back then had been for strict adherence to Section 46 of the Banking and Financial Institutions Act (BAFIA), which limits the shareholding of a banking institution to not more than 20% for corporations and 10% for individuals. We do not rule out a renewed drive under FSMP2 to pursue this objective. Shareholders potentially affected by this ruling include Tan Sri Teh Hong Piow (23.5% effective interest in Public Bank) and Tan Sri Quek Leng Chan (64.6% effective interest in Hong Leong Bank).

Admittedly, that the Maybank/CIMB and RHB Capital merger has fallen through is a major dampener. But merger talks have since returned with RHB Capital and OSK in the limelight presently, via a share transfer option.

Q M&A (mergers and acquisitions) in the Islamic banking space?

A With stepped-up competition in the Islamic banking space, particularly if licences to the two mega banks are granted, we foresee it increasingly difficult for standalone units such as Bank Islam and Bank Muamalat to compete over the longer term. Given that foreign shareholding limits for Islamic institutions have been liberalised to 70%, we see potential interest from both domestic and foreign entities for these two entities. Bank Islam is the third largest Islamic bank in the country by asset size and its shareholders are BIMB Holdings (51%), Dubai Financial Group (30.5%) and Lembaga Tabung Haji (18.5%). Bank Muamalat's shareholders are DRB-Hicom (70%) and Khazanah Nasional (30%).

Q Changes at investment banks (IBs)?

A Competing with a limited talent pool makes it tough going for standalone IBs, in our view, and compounding matters is that there is not much value to M&As among IBs either. In any case, of the seven standalone IBs, Kenanga and ECM Libra are expected to merge while MIMB is likely to be absorbed by Hong Leong, in our view. We would not rule out Kenanga-ECM Libra being on the prowl for a commercial bank to complement its investment banking activities. As for HwangDBS, a tie-up with Alliance Investment Bank may make commercial sense over the longer term, given that DBS' ultimate parent company is Temasek Holdings. ✱

■ Reporting by the *Banking Insight* Editorial Team.

Emerging Asia

EMERGING OPPORTUNITIES

SOO HOO KHOON YEAN

The global financial services industry continues to undergo an unprecedented period of change, arising from the financial crisis and its lingering effects. With global economic activities rapidly shifting eastwards, the prospects for growth in financial services (FS) markets are stronger in Asia than in any other region.

The re-emergence of Asia poses an opportunity for Malaysian banks to position themselves for a regional footprint. However, they continue to face increasing competition, as Asia's economic dynamos turn to the Asian market and crowd its landscape.

Recognising that M&A continues to be a key strategic tool for financial institutions in Asia, PwC launched its sixth annual Asian Financial Services M&A survey to explore the potential and insights for deal activity in the region.

Unlike previous years, this sixth Asian FS M&A survey response base was wider with 375 senior executives in Asia (out of whom 43 were from Malaysia). The survey was also backed with client interviews and analyses of M&A.

The survey results raised four key themes on Asian M&A activity. They are:

COMPETITION

THE RE-EMERGENCE OF ASIA poses an opportunity for Malaysian banks to position themselves for a regional footprint. However, they continue to face increasing competition, as Asia's economic dynamos turn to the Asian market and crowd its landscape.

CHART 1: ASIAN FS : POTENTIAL DEAL ACTIVITY SEGMENTS

FS Industry Segment	China	India	Indonesia	Malaysia	Australia	Vietnam
Asset Management	✓	✓			✓	
Trust	✓					
Banking			✓	✓		✓
Insurance	✓		✓	✓		
Non-bank finance		✓				

CHART 2: ASIAN FS M&A BY DEAL VALUE 2010, USD MILLION

Target Country	No. of Deals	Banking	Securities & capital markets	Mutual funds & asset mgmt	Insurance	Other	Total (USDm)
China	79	10,823	1,960	2,666	672	1,090	17,210
Australia	104	258	46	1,654	8,300	185	10,442
Japan	104	1,239	491	67	5,363	1,047	8,207
South Korea	29	4,479	61	28	1,520	426	6,514
Hong Kong	39	1,410	207	327	3,143	366	5,453
India	88	829	254	553	19	399	2,054
Thailand	17	20	-	1,112	-	194	1,326
Indonesia	51	704	17	4	44	30	799
Malaysia*	18	-	-	0	911	1	912
Taiwan	15	98	429	6	183	-	716
Singapore	16	-	4	228	313	2	547
Pakistan	8	279	-	-	-	-	279
Philippines	8	181	-	-	-	-	181
Kazakhstan	5	131	-	-	-	-	131
Bangladesh	3	55	-	-	17	32	104
New Zealand	17	-	-	31	2	48	81
Vietnam	23	11	45	3	11	-	69
Uzbekistan	3	17	-	-	-	-	17
Sri Lanka	13	2	3	2	2	-	9
Azerbaijan	2	2	-	-	-	-	2
Total	642	20,538	3,516	6,680	20,498	3,819	55,051

Source: Thomson Reuters, PwC analysis

1 Growth in Asian FS M&A

Asian deal values for the first half of 2011 totalled USD28bn, an increase of 40% year-on-year. Survey respondents are increasingly confident in their financial services deal appetite and its prospects for revenue growth.

Over the medium to longer-term, growth in Asian FS will continue to be driven by a range of supporting economic and demographic factors. This includes the rapid emergence of middle-income and affluent customers.

2 Strong strategic rationales drive domestic M&A

Domestic M&A remains the predominant driver of Asian FS transactions, driven by a range of strategic factors. These include:

- Domestic competition
- Growing pressure on operational and capital efficiency
- Ongoing divestments by strategic

Chart 3: Domestic business growth (next 12 mths)

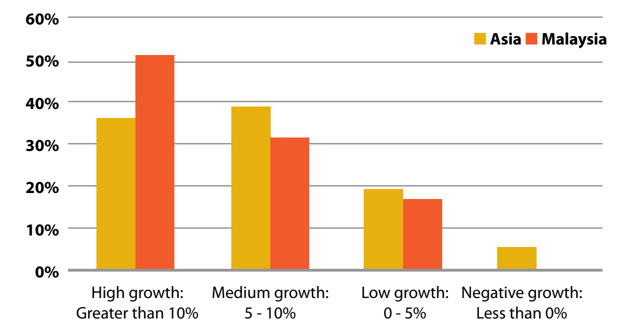
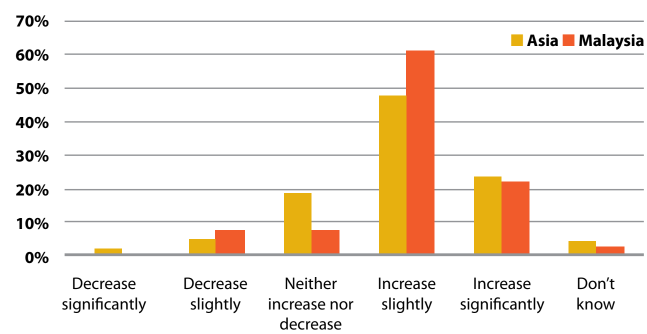


Chart 4: M&A expectations for your market (next 12 mths)



Source: PwC survey

investors from outside the region

- Acquiring customers, and expanding capabilities to offer sophisticated products to corporate and high net worth clients
- Encouraging the emergence of stronger institutions among national regulators in several markets including Malaysia.

3 Cross-border transactions gather momentum

Institutions across Asia see M&A as a crucial tool in the search for exposure to higher growth, spurring cross-border deals. Among the drivers of increased cross-border activities are:

- Companies from more mature markets such as Australia, Singapore, Japan and Korea. They are joined by European and American groups in the hunt for attractive Asian targets. With China joining the hunt for strategic targets in Asia, cross-border regional activities are expected to intensify.
- Companies from within Asia with regional ambitions are developing portfolios of strategic stakes, joint ventures and distribution partnerships.
- Companies which have strong cultural links in an intended country are targeted.

4 Capital restrictions are emerging as a key obstacle

Capital restrictions seem to be the main obstacle to financial services M&A in the region. The Basel III regime is a source of concern for many, and tighter capital regulation in many markets will have an effect on the size and type of M&A transactions.

Other M&A challenges include:

- Government intervention is viewed as both a stumbling block, as well as a short-term catalyst;
- Difficulties over deal valuation - while these are easing, it remains a significant obstacle in some markets; and
- Human capital issues are identified as the leading post-deal challenge for management.

What's ripe for the picking?

Despite renewed concerns over the global economic outlook, we believe that financial services M&A in Asia will accelerate over 2011 to 2012, driven by supportive long-term macro factors and a range of strategic factors.

Some of the FS industry segments where we see potential for deal activity is reflected in **Chart 1**.

Chart 2 provides further insights on FS sector deals across Asia in 2010.

What's our Malaysian FS landscape looking like?

There were a number of interesting observations arising from the Malaysian respondents.

Across a range of expectations including business growth, incidence of M&A, likelihood of M&A involvement and attractive targets, Malaysian FS respondent results were generally in line with the rest of Asia.

Malaysian FS players are generally optimistic about the next 12 months. They have:

Optimistic market expectations

Malaysian financial services respondents are among the most confident in Asia when it came to predicting domestic revenue growth. Half of those surveyed expect their organisation's top line to grow rapidly over the coming year.

Higher deal activity expectations

Compared to their Asian peers, there was higher deal confidence among Malaysian FS players – over 80% of respondents predicted higher deal activity for the year ahead. Recent announcements like the OSK-RHB merger, OCBC's acquisition of PacificMas and CIMB's potential cross-border transaction in the Philippines reflect industry optimism on M&A.

On the likelihood of M&A involvement

in the next 12 months, it is pertinent to note that:

- nearly half (49%) of Malaysian FS players are considering an M&A deal;
- A quarter (24%) have not decided; and
- 22% are highly unlikely to get involved in M&A deals.

In terms of most attractive territories, Malaysian FS respondents looking to enter new territories through M&A are focused on two very different markets:

- China for Asian growth opportunities; and
- Singapore for regional financial services' opportunities.

Another interesting aspect is that those surveyed were keen to do more business in Thailand.

M&A obstacles

Malaysian respondents are, on average, less concerned about potential obstacles to financial services M&A, compared to the wider Asian survey sample.

However, they are concerned about the potential effect of government or regulatory intervention on deal-making. Other key obstacles include:

- Price expectation gaps
- Lack of meaningful domestic opportunities

Looking ahead

Recent news that foreign ownership of commercial banks could be further liberalised in Malaysia's upcoming Financial Sector Masterplan 2, may drive further foreign participation in the domestic banking sector. From the survey results, it appears that Malaysian-based FS players are ready to step up their M&A activities into the medium-term.

To prepare for this, they can:

- Enter or expand into high-growth markets, whether in different provinces or different countries
- Accelerate customer acquisition – whether at home or in foreign markets
- Develop pan-Asian networks that improve diversification and offer more levers for future growth
- Develop financial conglomerates that offer a broader range of services, particularly to corporate and high net worth customers
- Counteract the growing competitive and profitability pressures being felt within many Asian domestic financial services markets
- Comply with regulatory requirements, including improving solvency, increasing competition, creating stronger national and regional players and enhancing management capabilities.
- Divest non-core activities and improve strategic focus, (this applies both to Asian groups and those from other regions)

The rate of acceleration of M&A activity in Malaysia will depend on whether the price expectation gaps between buyers and sellers can be narrowed.

More importantly, the Malaysian FS industry will look up to the success of recent deals and evaluate if its post-merger integration programmes have delivered the best returns on investment. ✱

Chart 5: Likelihood of involvement in M&A (next 12 mths)

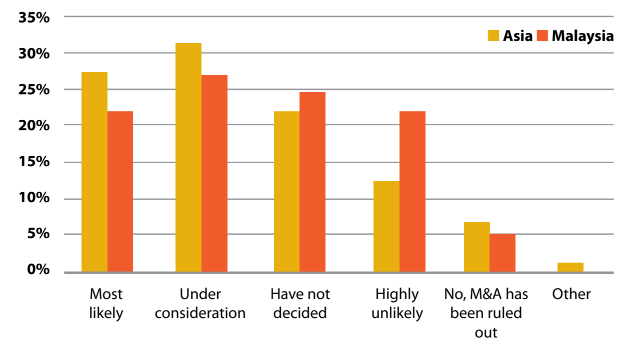


Chart 6: Most attractive territories

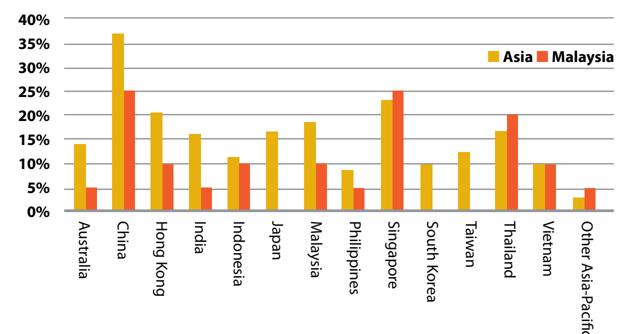
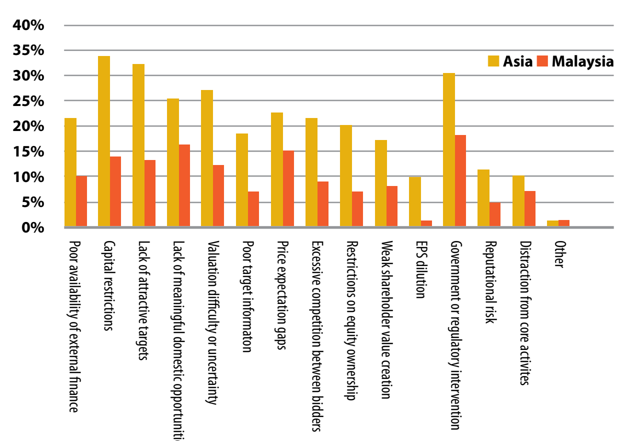


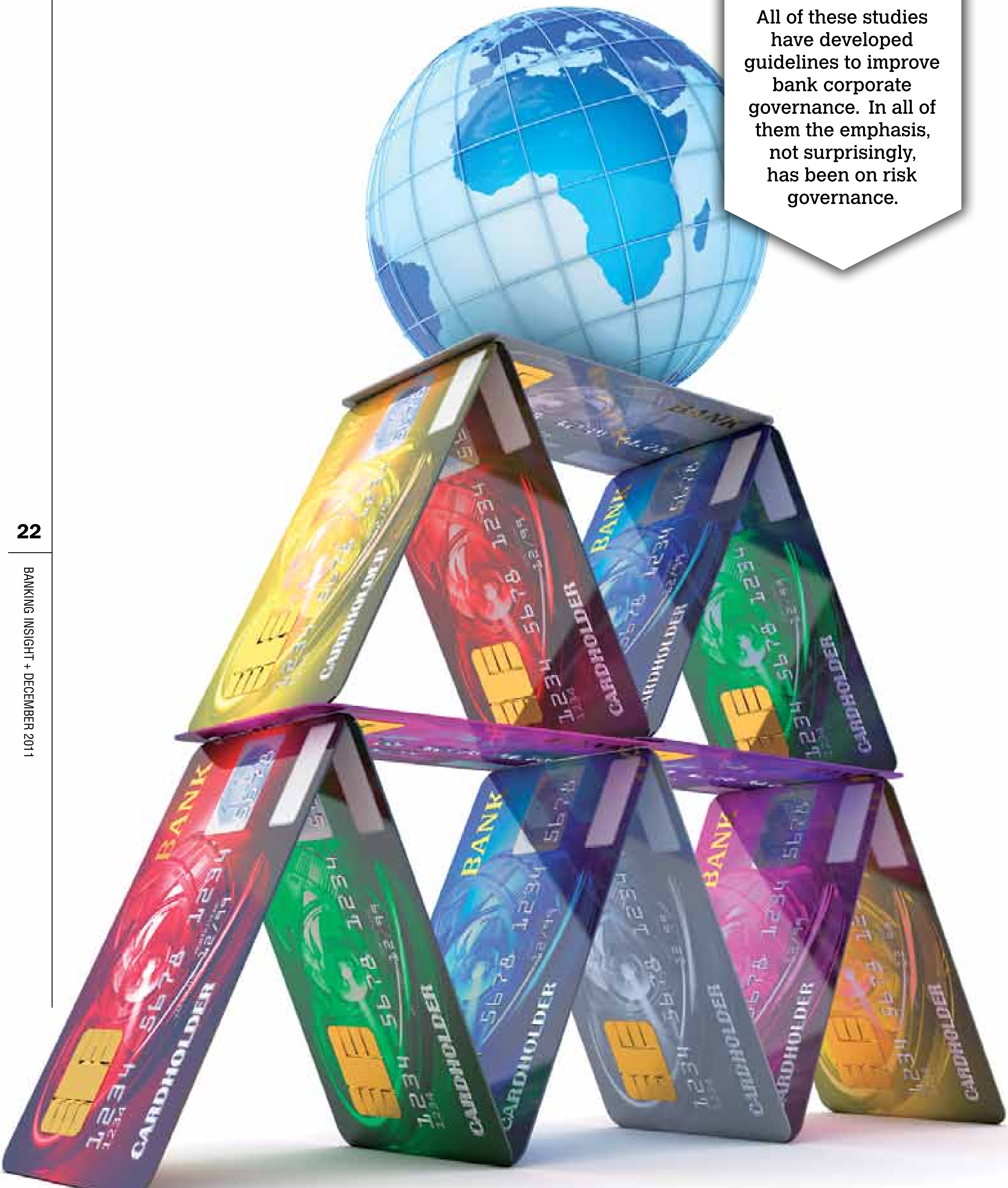
Chart 7: Principal obstacles to undertaking M&A



Source: PwC survey

■ Soo Hoo Khoon Yean is a Partner, Financial Services with PwC, Malaysia.

All of these studies have developed guidelines to improve bank corporate governance. In all of them the emphasis, not surprisingly, has been on risk governance.



Corporate Governance of Banks

PROFESSOR TED GARDENER

Introduction

In September 2011 the Wolpertinger Club of university banking researchers held its annual conference in Valencia, Spain. The hosts and organisers were the Instituto Valenciano de Investigaciones Económicas (IVIE) and the Universitat de Valencia. The 'Jack Revell Session' within the conference addresses practical policy and related issues, and the theme for this year was 'Business Models and Governance of Banks'. The platform was shared by Professors Gardener (*Bangor Business School, Bangor University*), Perez (IVIE) and Maudos (IVIE). The keynote speaker who opened the session was José María Roldán (Director-General of the Directorate General Banking Regulation, Bank of Spain).

The recent, indeed continuing, financial crisis (that began in 2007) has prompted an enormous theoretical and policy debate. Central to this debate are the post-crisis 'best' corporate governance systems and business models for banks going forward. These two questions are intextricably linked and the logical starting point is corporate governance. Without an adequate system of corporate governance, no banking business model is necessarily 'the best' or 'safe'. The following paper is the presentation of Professor Ted Gardener who explored some of the latest thinking and proposals for the post-crisis corporate governance of banks.

A PERFECT SYSTEM of corporate governance would provide managers with the right incentives to make value-maximising decisions for owners. Such a system, for example, would make sure that cash was paid out to investors when the company is unable to generate positive NPV (Net Present Value) investments. It would provide managers and employees with fair compensation, but would not allow excessive managerial and employee perks of any kind.

What is Corporate Governance?

Corporate governance in popular usage is concerned with the actions available to shareholders (owners) to influence and discipline managers' decisions. Economists use the term 'governance' in a wider context to cover all of the mechanisms through which managers are incentivised and controlled to act in the best interests of an organisation's owners.

A perfect system of corporate governance would provide managers with the right incentives to make value-maximising decisions for owners. Such a system, for example, would make sure that cash was paid out to investors when the company is unable to generate positive NPV (Net Present Value) investments. It would provide managers and employees with fair compensation, but would not allow excessive managerial and employee perks of any kind.

This view of corporate governance is the modern corporate finance vision. It is consistent with the free market model, where investors ultimately determine the internal resource allocation decisions of firms. In this world, shareholders wealth (or value) maximisation (SWM) is the dominant corporate objective.

During the modern (post-1970) era of banking, deregulation has moved global banking systems along this kind of free market trajectory. The many banking and financial crises of the modern era have not deflected this deregulation policy. The latest and most severe of these crises has prompted a serious debate and much re-thinking, but the discipline of the free market is still the preferred policy context in important banking countries like the US and UK.

BANKING HISTORY AND A RAFT OF special banking regulations reflect the practical importance of this kind of depositor and overall market confidence. The central bank lender of last resort function, deposit insurance and 'too big to fail' regulatory interventions are reflective of this unique feature of banks compared with non-banks. The 'costs' of these kinds of banking-unique regulatory interventions are borne ultimately by government and taxpayers.

Corporate Governance Out of the Wings

In the past ten years or so corporate governance has moved to a much more central position in the debate on banking structures, strategy and regulation. The wider economic model of deregulation that drove the development of banking markets appeared to accept the standard corporate finance model of corporate governance. The theory is that so long as markets are provided with sufficient information, they will ultimately discipline and incentivise the required, value-maximising behaviour.

Although the recent crisis has not interred this standard model of corporate finance in banking, it has certainly raised some fundamental questions. Following the UK Walker (2009) report, international organisations like Basel (2010), OECD (2010) and the European Union (2010) have all studied and reported on corporate governance in post-crisis banking.

All of these studies have developed guidelines to improve bank corporate governance. In all of them the emphasis, not surprisingly, has been on risk governance.

However, these studies vary markedly on what they consider to be the main objective of bank corporate governance. Broadly speaking, two main schools of thought can be identified. A shareholder-dominant approach (typified by Walker, although this does not imply that other stakeholders should be ignored) and a stakeholder-based one (typified by the Basel Committee and the EU). In the latter model, multiple stakeholders and their respective objectives are more strongly emphasised.

Banking is Different

The debate has also needed to address another fundamental issue. Banks are different compared with non-banking firms since all banking systems rest ultimately on confidence. It is through the continued maintenance of this market confidence that banks are able to carry out their unique and important economic functions. So long as bank depositors remain confident that their bank can repay its deposits on any day, banks are able to borrow short and lend longer. This confidence preservation is (and always has been) the bedrock of fractional reserve banking.

Banking history and a raft of special banking regulations reflect the practical importance of this kind of depositor and overall market confidence. The central bank lender of last resort function, deposit insurance and 'too big to fail' regulatory interventions are reflective of this unique feature of banks compared with non-banks. The 'costs' of these kinds of banking-unique regulatory interventions are borne ultimately by government and taxpayers. These costs can be high (especially in a crisis), but banks are uniquely important economic institutions and their fundamential importance to economic stability and growth are widely acknowledged.

These kinds of necessary, bank-unique regulatory interventions are also examples of 'market failures' in applying the standard corporate finance model to banks. This means simply that the model does not necessarily work as expected in allocating banking resources unless these kinds of market failures are at least recognised and their consequences (intended and otherwise) recognised.

At the same time, these kinds of regulatory interventions, these 'market failures', carry with them certain privileges and responsibilities that all banks enjoy. They enable banks to operate with higher levels of leverage and risk assumption than would otherwise be possible in a completely free market (where banks are treated like any other non-bank company). There has to be a price and a required level of professional responsibility assumed for these economic responsibilities and privileges.

Towards a Post-Crisis Model of Bank Corporate Governance

Where does the preceding lead us in devising an effective, post-crisis system of corporate governance for banks? What do we want from such a new system? I believe that there are three basic requirements.

First, the special role and unique economic position of banks must be recognised. Secondly, a system is needed that enables the free market model (deregulation) to work effectively and safely in disciplining the banking system and allocating resources in the most efficient way. Thirdly and following from the last point, the most important 'market failures' associated with modern banking need to be recognised and addressed.

These are complex requirements and there are no easy solutions. What banking history appears to confirm is that ever more regulations in key areas like risk, capital adequacy and liquidity are not the complete answer. These new rules may be necessary, but they are not sufficient by themselves. Indeed, ever more tight and detailed regulations may ultimately be risk-producing as banks attempt to innovate around the rules. Paradoxically, deregulation and more intensive competition may help stimulate this kind of regulation-avoidance behaviour.

So where does this lead? First of all it is clear that banks are 'different' compared with other firms. As we saw earlier, this special nature of the banking firm leads to the proposition that the duty of care (so-called 'fiduciary duties' to key stakeholders) is wider for bank directors. In particular, it should encompass bank depositors, especially retail depositors who do not have the expertise (or incentive, given the implied role of the central bank and government in helping to underpin, or 'backstop' banking confidence) to assess banking risks.

This is not a new proposition (see, for example, Macey O'Hara, 2003). In practice it means that bank directors must be fully cognisant of any decision that might impact badly on bank capital adequacy (solvency risk) and affect the ability of the bank to repay bank depositors. Bank directors and the senior management team would have a personal liability within this proposed framework.

By itself, though, this is not enough. The reason is that bank regulators are also a key party in evaluating and ultimately determining capital adequacy.

The key role of bank regulators in determining capital adequacy comes from the function of them setting (at least broadly) the level or extent of crisis scenario (downside risk) for which bank capital has ultimately to be adequate. The free market is not able (or incentivised) to do this. Even supervisors with all the information that they have cannot be precise in setting exact downside risk needs of banks, but it is they who have to have the final word on what level of bank risk cushioning is adequate.

This leads to a second proposition. Senior bank supervisors should have fiduciary duties of care to both banks and especially their customers in carrying out this important and unavoidable task. This is a more radical proposal and it has been promulgated in a recent paper by Dermine (2011) who proposed many other related features of such a system. ✱

■ Professor Ted Gardener is a Consultant Director to the Bangor Business School, Bangor University, which was ranked top in the UK in Accounting and Finance (including Banking) research within the latest Government Research Assessment Exercise (RAE). Professor Gardener has published over 200 papers, books and articles on banking and has undertaken research and consultancy for a wide range of bodies, including the European Commission, the World Bank, HM Treasury, EFTA and many banks.

✱ Conclusions

THE PROPOSALS LEAD to a kind of tripartite system of bank corporate governance. Requiring fiduciary duties of bank directors and the senior management team to bank depositors is one part. The second element is the requirement that bank supervisors also have fiduciary duties to bank depositors. Together such a system would enable banks to be subject also to the shareholder-based model of corporate governance. In such a system the latter might work more effectively and, at the same time, the probability of systemic shocks and contagion risk reduced.

It cannot be pretended that these proposals are an 'easy solution' and that some challenging practical issues still need to be addressed. Nor could one argue that they provide a guarantee of bank safety and prudence. But they would at least address the real problem of the 'market failures' we have discussed that characterise banking and which compromise an unaided free market solution to bank corporate governance. At the same time these proposals would surely put a premium on the professionalism, accountability and managerial quality that should now be demanded of bank supervisors, bank directors and senior managers.

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LEVELLING THE PLAYING FIELD

Financial inclusion, or the provision of access to basic financial services for the world's poor and marginalised is believed to be a meaningful way of engaging them and enhancing their social and economic welfare. Little wonder then that policymakers worldwide, including central banks and governments, want to harness existing financial infrastructure to deliver financial services to the less fortunate.

MAJELLA GOMES

Almost 2.5 billion people, almost one-third of the total population of this planet, do not have any means of accessing financial services. Research has shown that providing financial services at the most basic level – such as microfinance loans – can be a means of uplifting them, as done by Grameen Bank founder Muhammad Yunus in his quest to empower peasant women.

Emphasising financial inclusion – allowing more people to access appropriate and essential financial services and funding – is therefore a timely move by governments and regulators.

Getting Started

The first move should be to identify specific needs in the context of individual cultures and societies. What is needed by the marginalised in Malaysia would hardly be the same as requirements in say, Afghanistan or Somalia. Financially-excluded groups rarely have the same requirements, other than the need for funding.

In Malaysia, education and awareness are key components of financial engagement to uplift the marginalised. Badlisyah Abdul Ghani, CEO, CIMB Islamic Bank Berhad, pointed out that to be successful and sustainable, financial inclusivity will need to include a financial education component to ensure the financial literacy of the target market. “Besides having a product range that caters to the needs of the targeted consumers, we need to have well-informed industry players who understand these needs,” he said. “Technology-enhanced delivery channels will have to be developed to fill financial access gaps, and better monitoring will be essential, as well as consumer protection. Currently, most financial institutions undertaking this sort of financing have a single, one-size-fits-all kind of framework but a demand-driven approach will help create depth to financial inclusion.”

He added that when the issue of financial inclusion surfaces, the focus tends to be on the poor or the rural-based population but financial inclusion is really about everyone – the disabled, single parents, urban poor and other similarly marginalised communities.

Opportunities from Inclusion

Noting that Bank Negara Malaysia has actually made financial inclusion a social and economic agenda, Datuk Kamaruzaman Che Mat, Managing Director, Bank Kerjasama Rakyat Malaysia Berhad or better known as Bank Rakyat, pointed out that there were actually opportunities for banks to broaden

But how would banks reconcile their efforts towards inclusivity, which inevitably incur costs, with their bottom line, or explain it to shareholders?

their customer base while becoming more involved in societal development, through financial inclusion. “Micro financing, pawnbroking, Internet banking, mobile banking and the provision of more ATMs can be considered,” he said. “A larger segment of the population, including middle to lower-income earners, students, micro-entrepreneurs, small co-operatives and rural residents can benefit from this.”

But how would banks reconcile their efforts towards inclusivity, which inevitably incur costs, with their bottom line, or explain it to shareholders? Datuk Kamaruzaman stressed that it was about creating long-term value and lengthening the bank’s outreach more than anything else. “Also, it builds a positive image of the bank in a multi-level society,” he said. “Besides, economies of scale can be achieved when we reach enough customers, which we can do through mass delivery methods.”

Acknowledging that institutions undertaking financial inclusion measures must first have a profitable, commercially-viable business, Badlisyah said that financial inclusion products can nevertheless be profitable. “They are generally undertaken based on the risk-return profile,” he explained. “It may be an expensive proposition but the cost incurred must be commensurate with the risk taken.”

Growing awareness

Institutional hesitation notwithstanding, awareness and understanding of the need to extend financial products and services to the poorest of the poor is growing. In some countries, small measures have already produced big gains. In Kenya, for instance, money transfer services through mobile phone technology has helped increase access to finance for all levels of

Bank Negara Malaysia (BNM) and the Alliance for Financial Inclusion (AFI), participants were urged to consider the development of a composite index that would encompass trends, facilitate comparisons between segments and create a benchmark for policy work. Said Dato' Muhammad Ibrahim, Deputy Governor, BNM, in his speech: "This could eventually help popularise the notion of financial inclusivity, and spur global support for financial inclusion initiatives worldwide."

The two-day workshop culminated in the launch of a working group of expert policymakers and supervisors from central banks and supervisory bodies of developing countries and emerging economies, including Brazil, Burundi, Indonesia, Kenya, Malaysia, Mexico, Nigeria, Peru, Philippines, Uganda and Zambia, that will focus on improving national-level collection and use of financial inclusion data. Together, these representatives will look at possible ways that common global indicators and basic standards for financial inclusion surveys and data collection may be established.

One major result is that the developing-country voice and perspectives are beginning to be heard in global debates that focus on new policy formulation in the light of the recent global financial crisis.

society, and has especially benefitted the poor. Innovative approaches to financial inclusion in Indonesia include financial identity initiatives, and in the Philippines, mobile financial services are fast becoming viable. Fiji, Papua New Guinea, the Solomon Islands, Samoa, Vanuatu and Timor Leste are all looking at policies and regulations that will help people to save or transfer money more efficiently with the help of technological innovation.

All these countries are well aware of the magnitude of the task ahead of them, and the fact that one of the most pressing needs in connection with financial inclusion is the collection and use of appropriate data. This is a critical element that is often lacking in policy development and implementation. Reliable data is imperative to effective policy formulation and implementation. The absence of it, particularly in developing countries, results in an incomplete picture of a country's situation, which may well result in the formulation of ineffective policies and programmes.

Interest in the issue is not a recent phenomenon; the realisation that the neediest have the least access to funds has been around for some time. At an international workshop held a few years ago in Malaysia, hosted by

Necessities of financial inclusion

It is encouraging to note that many developing countries are viewing the matter with great concern, and it is to be lauded that they are collaborating on several fronts. One major result is that the developing-country voice and perspectives are beginning to be heard in global debates that focus on new policy formulation in the light of the recent global financial crisis. This has been acknowledged at the international level, with AFI Executive Director Alfred Hannig pointing out in his speech that "listening to, and learning from developing country experience represents a new approach to development that will be fundamental to the success of financial inclusion initiatives."

But more needs to be done before the objectives of financial inclusion are achieved. In addition to robust data, leadership, coordination and innovation

are pivotal to success in this area, and a great deal depends on the countries themselves. Regulations, for instance, need to be tightened. These vary from one country to another, and could give rise to difficulties with the institution of digital fund transfers using mobile telephone technology. There are also instances where even opening a bank account is a major obstacle. As an example, it is estimated that some 80% of Pacific Islanders do not have even a savings account.

The next step

There is general agreement among all countries that strong leadership and an unwavering commitment to poverty alleviation must prevail for financial inclusion to work. This is in addition to cooperation on different levels, knowledge-sharing and transfer of skills. All this will require a concerted effort in the area of financial education, through which financial access can be broadened, financial services can be further extended, and communities empowered. Since almost one-third of the world's population currently lack access to even basic financial services, improving access will result in the unlocking of their economic potential.

As examples of what can be achieved when all parties collaborate, at the AFI's Global Policy Forum in Mexico in September 2011, Brazil announced that it would launch a National Partnership for Financial Inclusion while Tanzania pledged to raise its financial access level to 50% of its population through mobile banking and other initiatives. Nigeria declared it would work to reduce its unbanked by 50%, by 2020, and Zambia said it would raise financial inclusion to 50% by 2013. While Rwanda set a target of achieving 80% by 2017, Peru said it would enact a new law regulating electronic money within the next 12 months.

Here at home, the Central Bank of Malaysia Act 2009 reflects the country's commitment to financial inclusion, and there have been positive results. In Malaysia, there are 3,300 deposit accounts per 1,000 adults and 1,100 loan accounts per 1,000 adults – among the highest in the world. Basic banking products are available at reasonable cost, and all banks are required to provide such services to ensure all segments of society have access to them. Microfinancing rates are not capped to allow for easy provision, and financial institutions are encouraged to establish extensive networks nationwide to ensure physical access. Enhanced financial literacy and consumer protection help prevent exploitation of users by predatory schemes.

Where serious efforts have been made at developing financially-inclusive policies and programmes, positive results can already be seen. Hannig believes that some of the solutions that have successfully increased access to financial services for the needy have been created in developing countries themselves. "Peer learning, mutual exchanges and successful replication of innovative methods have played a pivotal role in expanding financial inclusion," he said. "But mobile or agent banking, micro-saving, consumer protection associated with these, together with state banking reform and financial identity systems, need to be better understood and implemented if financial inclusion is to realise its full potential." ✱

All this will require a concerted effort in the area of financial education, through which financial access can be broadened, financial services can be further extended, and communities empowered.

■ Majella Gomes is a senior freelance journalist based in Kuala Lumpur.

Progress?

...as a whole, the economic theories which have driven us for the last few decades are reaching the end of their useful life.

NO MORE GROWTH, PLEASE!

WE NEED TO DITCH GROWTH AS A MEASURE OF ECONOMIC PROGRESS

■ GRAEME MAXTON

How do we measure human progress? It seems a rather heavy and philosophical question. Yet it is one that should concern us all, and for two reasons. First, the way we measure progress today is wrong-headed. Second, it has hit the buffers, at least in most of the developed world.

If an alien made a journey to planet Earth and picked up a newspaper he would quickly assume that the most important motivator of human activity is economic growth. Every day, the headlines fret about the pace of growth, about the rate of spending and about how stimulus packages can be used to restart stalled Western economies.

This is madness. The largest component of most economies is consumption. Consumption accounts for 70% of the US economy and much the same in Europe and Japan. It is the largest share of the world economy. For us to achieve economic growth therefore, we must increase consumption. To do that, people must spend more, which means they have to earn more or borrow more.

Apart from being morally vacuous and financially daft, driving millions of people into debt, this desire for growth goes against the laws of nature. As human beings, we don't grow forever. We reach a steady state and then stay that way. Trees and plants and other animals do the same. So why are economies any different? As Kenneth Boulding, John F. Kennedy's environmental advisor once said, "anyone who believes in indefinite growth in anything physical, on a physically finite planet, is either mad - or an economist".

More worrying, the idea that growth can be a measure of development is in trouble. The growth-driven model of the last 30 years is coming to an end. It may not be coming to an end in Malaysia, but for the world as a whole, the economic theories which have driven us for the last few decades are reaching the end of their useful life.

For most of us alive today, that may seem odd, because the notion that economies should grow has been the dominant economic concept for most of our lives. The thinking is simple enough. The more we buy, the more we can produce. The more we produce, the more jobs there will be. With more jobs comes more spending. Then comes more economic growth. This is our path to progress.

Yet the notion that we should see economic growth as an objective is a comparatively recent one. It only really caught on during the early 1980s, when Ronald Reagan took over the US presidency and the 'Washington Consensus' took hold – a movement led by a group of economists driven by the mantra, 'the market is always right, government is always wrong'.

Instead of providing us with a sustainable, meaningful path, modern economics has brought us a world which is socially and economically unstable.

Perhaps more surprising, this approach actually runs counter to the laws of proper, classical economics.

Modern economic ideas encourage us to focus on the short-term. They let businesses think that they must maximise profits regardless of the long-term consequences. This makes them outsource production to cut costs, use resources on the cheap, renege on pension promises and pollute the world without much care.

Instead of providing us with a sustainable, meaningful path, modern economics has brought us a world which is socially and economically unstable. It is responsible for a mountain of debt in the West, the rise of undependable low-grade employment in much of the world and the increase in obesity. In the developing world, although millions were lifted out of absolute poverty for a while, the financial crisis pushed most of them back where they started. Almost everywhere, the gap between rich and poor is wider than today than it has been for decades.

As governments around the world cut taxes to attract investment, their citizens have been abandoned, left with the airy hope that the free market will somehow save them. But it hasn't.

The ideology of the cancer cell

■ Without change, we are heading for trouble. The world faces a financial catastrophe because of the flood of borrowing in Europe, the US and Japan. All of us face increasing resource constraints, with oil and water shortages in particular, because of their over-use and our over-population. We even face declining life expectancies in much of the world due to climate change, food shortages and overloaded healthcare systems.

If we carry on pursuing this warped economic direction, we will come into conflict too. Tensions will rise over resources. Frustrations will grow in the poorest parts of the world as it becomes clear that hoped-for dreams of development simply cannot be achieved. Those living in the developed world will revolt

"THE RELIGION OF ENDLESS GROWTH IS A KIND OF MANIA, A FORM OF LUNACY, INDEED

We need to realise that we cannot simply patch the existing economic system as we have been doing with quantitative easing measures and bailouts. Something more fundamental is necessary.

against the perceived injustices they are about to experience – higher prices for the items essential to their lives, falling asset values and evaporating savings, with once-promised pension and healthcare payments denied.

We need to realise that we cannot simply patch the existing economic system as we have been doing with quantitative easing measures and bailouts. Something more fundamental is necessary. At the core, we need to rethink our notions of progress.

Classical economic theories say that companies and societies should think about the long term. They say that consumers should pay the full price for what they buy, not be subsidised by the environment and future generations. They say that markets should be regulated when necessary and that scarce resources should be protected. They say that the gap between rich and poor needs to be managed. For Adam Smith, who was first a professor of moral philosophy, essential elements of his sort of economics were fairness and justice.

Modern economic thinking has made us all believe that growth should be a goal, not a consequence. It has promoted waste, excess choice and a throw-away culture. It has encouraged under-regulation. It has provided a dream to those living in countries like China and India that cannot come true. It has made it impossible for many developing economies to progress. It has also overvalued our future – our investments, our companies, and our assets.

All these problems will be resolved, of course. It is how they are resolved that is the question.

We can probably find a way to overcome the debts and the resource shortages. We can find diplomatic answers to many sources of conflict. But much thought will need to be given to dreams and expectations. Billions of people will need to lower their hopes for the future – and substantially. Many developing countries will need to accept that they have been condemned by the current system. Billions around the world will have to modify what they do, cut their resource use and change what they value, whether they want to or not.

You and me

■ To address these challenges successfully will need cooperation, consensus and leadership. It will need your participation too, and mine. It makes no sense for us to see injustices accumulating, to watch the world's resources being squandered or sit idly by while more debts accumulate for our grandchildren to pay.

All of us need to question our modern economic model, with its promises of endless growth fuelled by consumption, widening income inequality and debt.

A DISEASE. GROWTH FOR THE SAKE OF GROWTH IS THE IDEOLOGY OF THE CANCER CELL."

Too many of us believed, almost without thinking, that growth was good, that it was a valid measure of human progress. We believed that unregulated free markets were the most efficient way to allocate the world's resources. We believed that globalisation was advantageous for everyone, despite the unequal way in which the benefits accrued. We believed that big businesses and big banks would behave benevolently, and in our interests, just as long as they were free from government interference.

As well as blaming ourselves for this foolishness, we need to blame the economists for their sloppy thinking and the politicians for selling us such twaddle. Our belief in these wrong-headed ideas has allowed economic power and wealth to become concentrated in the hands of a few people and institutions, with the combined wealth of the 793 richest people now equal to that of the three billion poorest.

We need to think differently about inequality, poverty and population. We need to think about how we can restore the bonds of good society.

We also need to ask ourselves how we should measure progress. There are a vast array of ways in which humanity can be fulfilled – social, religious, cultural, intellectual and spiritual – which do not drain the planet of its resources or promote disharmony. We need to develop a model for the future that does not hold us captive to the market. We need to think differently about inequality, poverty and population. We need to think about how we can restore the bonds of good society. We need not abandon free market economic ideas entirely – but we need to ensure that our economies are managed to meet our needs – all of our needs.

"The religion of endless growth is a kind of mania, a form of lunacy, indeed a disease. Growth for the sake of growth is the ideology of the cancer cell."*

It's time we found a cure. ✱

** Edward Abbey, an American author, 1988*

■ Graeme Maxton is an economist, author and presenter. His latest book, *The End of Progress, How Modern Economics Has Failed Us,* deals with the aftermath of the financial crisis, overpopulation, resource depletion and the emergence of China as a global power. A freelance contributor to *The Economist*, he is also a frequent host on CNBC's Squawk Box and Capital Connection and a regular guest on BBC and CNN news programmes. He is based in Austria and Singapore. Graeme Maxton's latest book, *The End of Progress, How Modern Economics Has Failed Us,* is published by Wiley. It has been nominated for the Financial Times and Goldman Sachs Business Book of the Year Award 2011.

Reforms, Ethics and Education in banks

TAY KAY LUAN

As political leaders and regulators put together the appropriate solutions to fix the problems of the Eurozone debt crisis, one lesson they need to bear in mind is that the current problem is not entirely the fault of poor regulation but of ethics. Business history will remind us that one root cause of the current financial contagion is the pursuit of self-interest, greed and selfishness in financial markets, and the inability of systems to detect and prevent the risk of overleveraging and insider trading.

The current crisis was preceded by long runs of rapid growth of cheap and easy credit, price inflation and the creation of bubbles in property markets. Overstretched leveraging also put a strain on financial institutions, creating unnecessary risk to any shift in economic cycle.

Financial markets are critical drivers to the prosperity and development of national economies all around the world. However, when financial markets operate without a strong ethical base, it will put at risk the public interest it is meant to serve and protect. Ethical issues in the financial services industry affect everyone, because of the direct impacts on the economies it operates in.

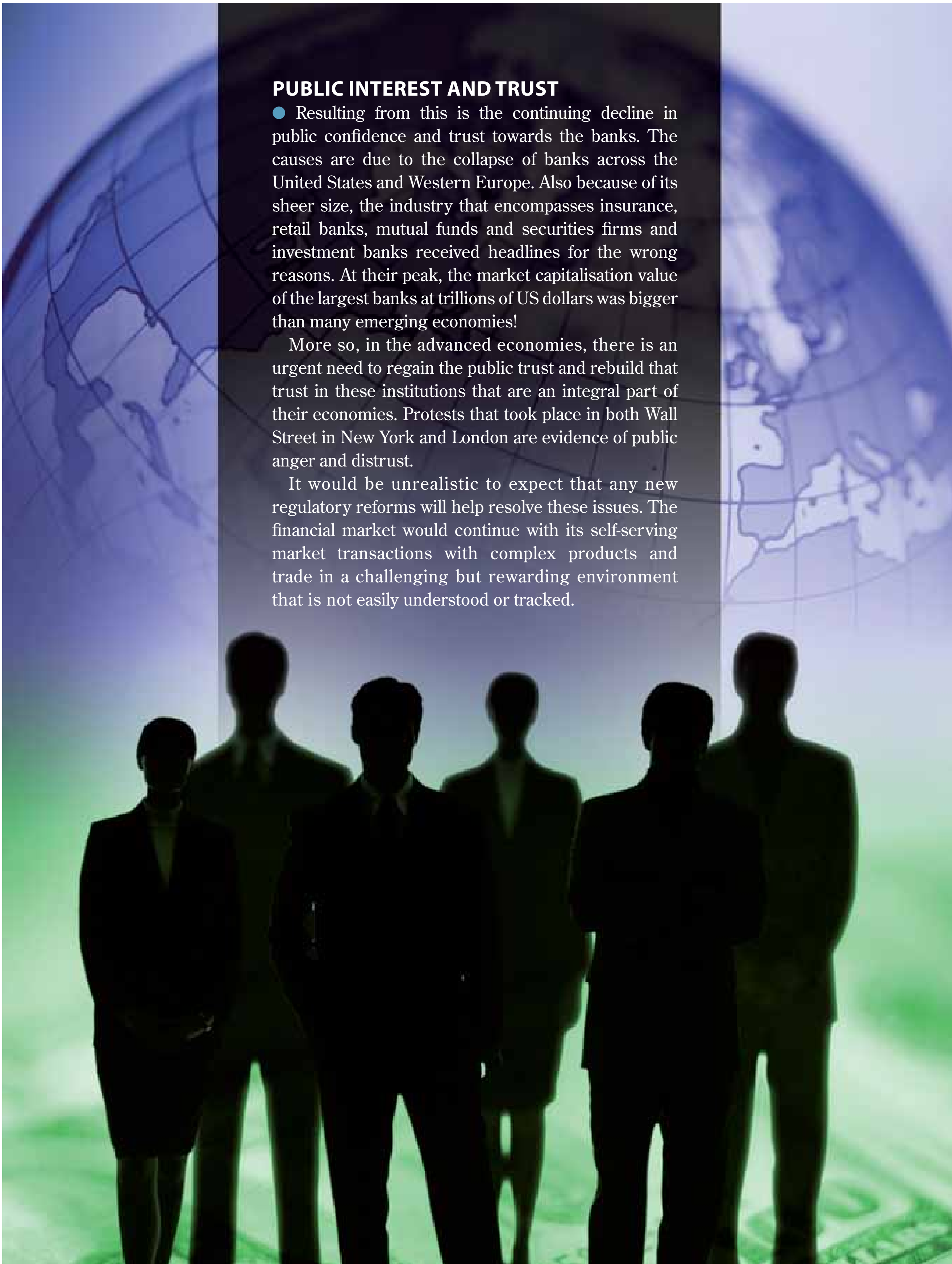
ETHICAL LEADERSHIP COUNTS

The importance of ethical leadership hence is important towards addressing these issues as well as the way the industry operates. Leading business thinkers and experts believe that ethical leadership is simply the way leaders behave and apply the principles of integrity and values of accountability and trust. By demonstrating the right character, and walking the "right values", the ethical leader can set the example for others and withstand any temptations that may occur along the way.

In reality ethical leadership is critical towards the sustainability of organisations. Drawing a parallel example, leadership failure in upholding the ethical principles at Enron and WorldCom has largely been blamed for the demise of what were formerly Fortune's Most Admired Companies.

Root cause

The current crisis was preceded by long runs of rapid growth of cheap and easy credit, price inflation and the creation of bubbles in property markets.



PUBLIC INTEREST AND TRUST

Resulting from this is the continuing decline in public confidence and trust towards the banks. The causes are due to the collapse of banks across the United States and Western Europe. Also because of its sheer size, the industry that encompasses insurance, retail banks, mutual funds and securities firms and investment banks received headlines for the wrong reasons. At their peak, the market capitalisation value of the largest banks at trillions of US dollars was bigger than many emerging economies!

More so, in the advanced economies, there is an urgent need to regain the public trust and rebuild that trust in these institutions that are an integral part of their economies. Protests that took place in both Wall Street in New York and London are evidence of public anger and distrust.

It would be unrealistic to expect that any new regulatory reforms will help resolve these issues. The financial market would continue with its self-serving market transactions with complex products and trade in a challenging but rewarding environment that is not easily understood or tracked.

REFORMS IN EDUCATION

Attention should then be focused on reforms to education curriculum. Ethical training should be mandatory in all education and training curriculum in all financial institutions. Ethics should also be taken into account in the recruitment process. Embedding ethical components and values would raise the consciousness and capacities of bank professionals, perhaps even shaping behaviours at all levels, including the senior management.

Current initiatives by the Chartered Bankers Institute and the banking institutes of Hong Kong, India, Malaysia and several others as to define what constitutes acceptable and unacceptable standards of behaviours for bankers have begun. As there are presently no definitive or internationally acceptable agreed answers to these, efforts to improve and define proper ethical and professional standards that are universally accepted are commendable.

TOWARDS COMMON GLOBAL STANDARDS

It is also necessary to establish an International Banking Education Standards Board whose remit would be to develop clear, internationally agreed benchmarks against which colleagues, customers, regulators and others can measure bankers' ethical and professional competence. It will work to support national banking institutes and regional bodies in promoting rigorous ethical and professional standards and facilitate the sharing and development of best practice between national institutes and regulators. It will provide one of the ethical foundations on which the global banking industry can rebuild the human capital on which a successful and sustainable banking industry is based. Its aim, quite simply, is to enhance ethics and professionalism in banking worldwide.

The intent is to ensure that customers, policymakers and regulators will be reassured by an unequivocal demonstration of the banking industry's determination to encourage agreed (consensual), industry-wide standards of ethical professionalism. For bankers, this will put in place a universal language to the development of the curriculum, ensuring a greater professional culture on responsibility and ethical leadership. National banking institutes and regional bodies will be supported in their efforts to develop an ethical and professional culture by being able to adopt internationally agreed standards and call on the expertise and experience of their peers. Most importantly, the banking industry will need to be built on a solid foundation of human capital committed to high standards of ethical, professional and technical competence.

APPLIED ETHICS CURRICULUM

Reforms on curriculum should ensure that ethical competence be applied, focusing on the moral values and judgements across the varied practices in banking. The emphasis should be applied across all levels and due to the diverse range of banking services, focus would be drawn to acceptable standards. It is recognised that fraud in banking can arise from a variety of malpractices or even legitimate practices. Often, problems come to light late, and may escape the attention of auditors. While studies show that education may solve half the problem, the bank's corporate culture is equally important to shape employee behaviour. Degradation of ethical values may also be a result of the internal environment. While ethical codes of conduct are necessary support, the promotion of right behaviours and values through training individuals to adhere and comply with ethical principles when making decisions is equally essential. Ethics training needs to be delivered through a series of applied case studies, proper "testing" and reinforced at various stages of learning - formal and informal!

It is also necessary to establish an International Banking Education Standards Board whose remit would be to develop clear, internationally agreed benchmarks against which colleagues, customers, regulators and others can measure bankers' ethical and professional competence.

Progress has already been made in a number of universities. Greater emphasis on ethics has already been taken in the undergraduate curriculum in top universities. Many of these institutions in the United States, United Kingdom and Australia regard ethics as an important component of the graduate skill set as its importance has been demonstrated in the failure of financial institutions.

In grappling with the issues of ethics at banks' workplaces, many employers will face the challenge of not only putting in place a robust framework in an already regulated environment, but that of education. Educating employees nonetheless is necessary as responsible banks are accountable to the community at large. In this context, it is necessary for banks to ensure public interests are protected through professional conduct and actions reflecting the values the banks espouse. In the final analysis, the value propositions are clear – reforms in educating banks on ethics standards to protect the interest of the community at large are overdue, and high ethical standards cannot be compromised. ✱

Tay Kay Luan is the Chief Executive of the Institute *of* Bankers Malaysia.

Global

Banking is a global business, borderless in its reach; we need to structure its "oversight" on the same basis.

PROFESSIONALISING OUR BANKING PROFESSION

ANGUS MACLENNAN

If you are unlucky enough to need surgery for a medical condition, it would never occur to you to wonder if the surgeon was appropriately qualified. If you need advice from a reputable law firm, an accounting firm, engineering, dentistry…. the list goes on and on.

These are all true professions where professional standards are set and maintained by a strictly applied and robust combination of professional qualifications, codes of ethics, and behavioural guidelines.

Conversely, if you go to a bank for advice, you have no idea whether the bankers have the appropriate qualifications to advise you, or even any qualifications at all.

Yet it is our banking 'profession' which is the most cited amongst parties deemed guilty of bringing the world's financial system to its knees. No doubt it is potentially the most toxic profession, but yet is the least professionally structured.

Instead, all we have are localised initiatives, some at country and sometimes regional level, some at individual bank level, but nothing which is global or universal, and covering all aspects of banking – retail, commercial, wholesale and investment banking, domestic and international.

Banking is a global business, borderless in its reach; we need to structure its "oversight" on the same basis.

As mentioned by Simon Thompson, CEO of the Chartered Banker Institute, in the June edition of *Banking Insight,* banking is as much about human capital as it is about financial capital. Since the onset of the financial crisis there have been numerous initiatives aimed at ensuring that banks and the financial system generally are better able to withstand future crises. We have had the G20, Financial Stability Board, IMF, the EU, Dodd-Frank in the US, the Basel Committee, the Bank of England, and numerous others, all producing lengthy papers on how to better deal with future crises, tackling the usual issues such as the need for enhanced capital, tougher liquidity rules, living wills, recovery and resolution planning.

All these initiatives however are aimed at enhancing the size of cushions to help banks to better absorb future shocks, and thus prevent governments from having to bail them out once again, using taxpayers money.

STRUCTURE

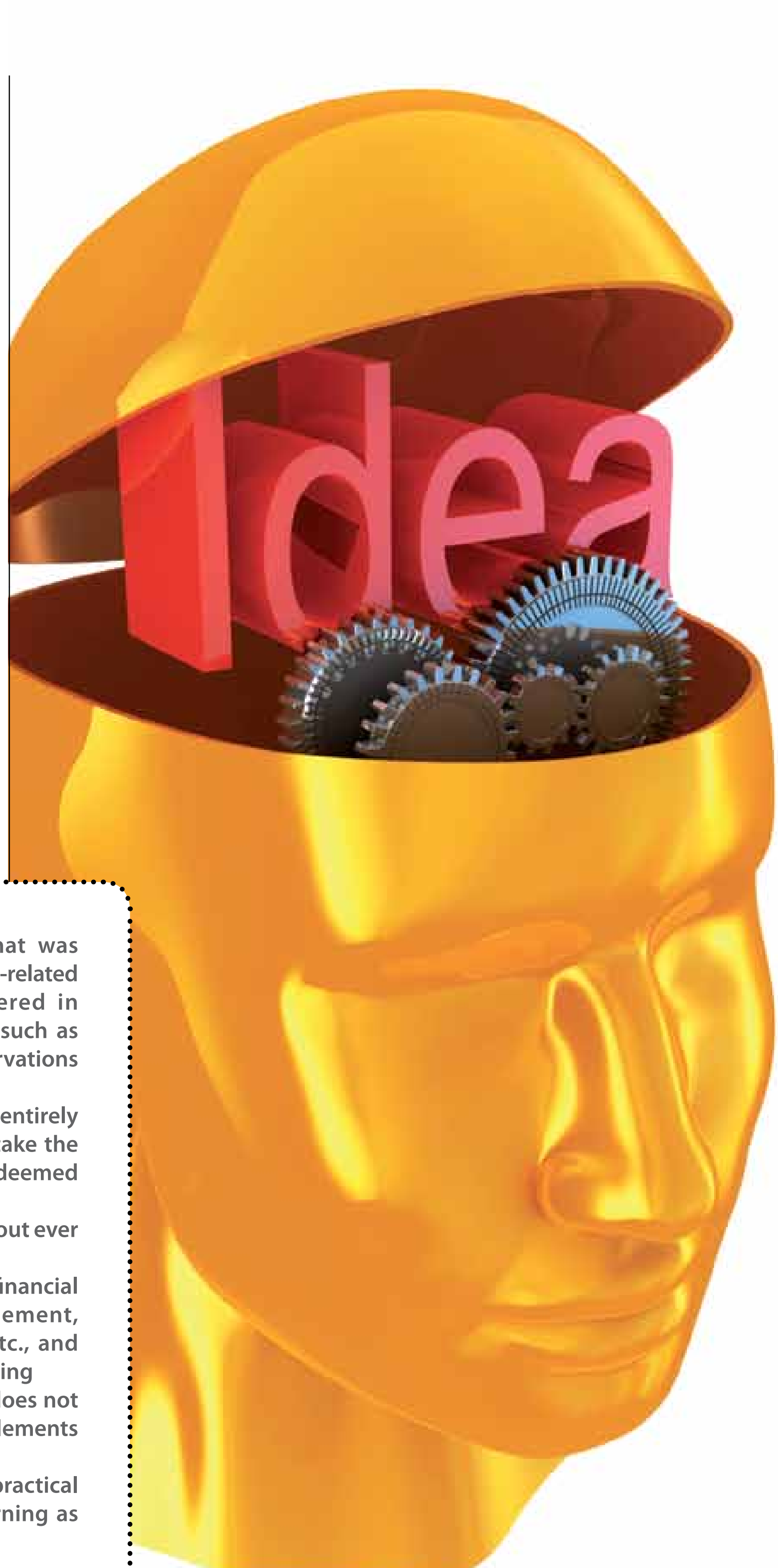
CONVERSELY, IF YOU GO TO A BANK for advice, you have no idea whether the bankers have the appropriate qualifications to advise you, or even any qualifications at all. Yet it is our banking 'profession' which is the most cited amongst parties deemed guilty of bringing the world's financial system to its knees. No doubt it is potentially the most toxic profession, but yet is the least professionally structured.

None of them tackle the prevention of future crises!

None of them tackle the issue of human capital, so we can ensure that the next generation of bankers just don't get us into the same problems as we have seen these past three years.

That is a shortcoming which we in the Institute of Risk Standards & Qualifications (iRSQ) are seeking to address. iRSQ was created over two years ago, with a remit to create a global standard of qualification for bankers, encompassing not only technical competence, but also a wider understanding of risk dynamics and a heavy emphasis on the psychological/sociological aspects of bankers' behaviour, ethics, culture and governance.

We approached our task by first seeking to understand precisely why it was that some banks seemed to cope so much better with the crisis, why others collapsed, and so many in the middle managed to survive only with a lot of government and other outside help.



SIMULTANEOUSLY, we looked at what was already out there in terms of banking-related qualifications, including those offered in academic establishments, and bodies such as GARP, PRMIA, CFA and others. Our observations were that :

- the existing offerings were almost entirely technical in nature, i.e., you undertake the studies, pass the exam, and you are deemed to be appropriately qualified
- you can sit and pass the exams without ever having worked in a bank
- they cover the whole gambit of financial services, including asset management, insurance, wealth management etc., and are not focused exclusively on banking
- the content, being only technical, does not touch on the behavioural finance elements which are so necessary
- they do not have any element of practical experience and application of learning as part of their qualifications

SHORTCOMINGS

In fact, if you consider banks that did fail, they did not run into difficulties because of a lack of technically qualified people; it was to do with something much deeper than that. Shortcomings in governance, behaviours, risk culture and reward structures.

In fact, if you consider banks that did fail, they did not run into difficulties because of a lack of technically qualified people; it was to do with something much deeper than that. Shortcomings in governance, behaviours, risk culture and reward structures.

So, armed with this background information, we 'signed up' a group of Chief Risk Officers (CROs), Chief Credit Officers (CCOs), subject matter experts, and some academics (collectively christened the Curriculum Advisory Council), and embarked on the task of creating a qualification for bankers which plugged the identified gaps and which tackled the reasons behind the shortcomings of bankers' behaviour leading up to the crisis.

Thus the iRSQ was created by a practitioner-driven group, *in situ* at a range of different regional and international banks, across a number of geographies, and supplemented by expertise on subjects such as behavioural finance, ethics, etc.

an independent board, transparent governance, and a clear routemap in terms of setting and vetting the standards of competence for its banking qualification.

It is important to note that iRSQ is not a commercial body, it is a not-for-profit organisation whose mission is to unite the banking world around a universal standard for bankers across the globe.

In so doing, it creates and maintains the standards, sets the examinations, maintains the relevance of the programme through continuous updating of the curriculum, and maintains the integrity and independence of the qualification.

The Institute does not offer any training, instead it licences others to do so, be they commercial training organisations, academic institutions, or banks themselves. In addition, with a strong desire not to "reinvent the wheel", the Institute is pursuing close collaboration and mutual recognition with some of the pre-existing bodies listed earlier, and is in discussions with a number of banking institutes around the globe as to ways of collaboration.

...the most critical issue in ensuring that a bank is able to withstand the market challenges which inevitably come, is the quality and depth of a bank's people, from top to bottom.

Whilst under construction, the programme was also shared with the likes of the UK's Bank of England, the FSA, and the UK Government's Treasury Department, so that they could also provide input and comment from a typical regulator's perspective.

The final product therefore, was a result of many iterations, with input from a wide range of high value contributors, no doubt a telling factor also in the decision of the UK Governments' Office of Qualifications (OFQUAL) granting the iRSQ programme professional accreditation status.

OFQUAL therefore, is iRSQ's formal regulator, and it has set clear rules of engagement for the Institute, ensuring

Typically, countries' Institute of Bankers (IoBs) have mostly focused on what can generally be described as retail, SME and commercial banking qualifications. The scope is for these IoBs to co-sponsor iRSQ towards their target audience and thereby add the wholesale/international element together with the wider elements around culture, behaviour and ethics. In so doing they not only produce better rounded and more competent bankers, but also gives the whole country a more secure banking environment. Furthermore it can assist in attracting and retaining the right talent in a bank or a country, and hence stop the brain drain to other markets.

Why does all this matter?

Banking, since its very earliest creation, has been based on trust. Trust between banker and customer no doubt, but also between banker and other stakeholders, including shareholders, the government in the countries in which they operate, and of course the wider societies in which they ply their trade.

That bond of trust has been badly broken in a number of jurisdictions, where banks are now booed and hissed, having attained the status of being the worst pariahs of society.

As a career banker, it saddens me to say that little has changed since the start of the financial crisis.

I have observed many senior bankers appearing before politicians and others, and being contrite and apologetic about their institutions' role in the crisis. Yet many of these same people whom I have had the opportunity of meeting in private, do not "walk the talk". Greed (the wrong sort!) remains alive and well, short-termism lives on, and governments and regulators are seen as being over-intrusive into their daily lives.

The fact that so many banks remain open for business solely due to intervention by these same governments appears to have been quickly forgotten.

It is quite right however to balance such accusations by acknowledging that in many parts of the world, not least in Asia and the Middle East, banking institutions have remained strong, and there has not been any evidence of mismanagement, bad governance, or insufficient risk culture.

It is dangerous though to adopt a mantle of "we're all right Jack".

The world is now a highly interconnected place, and events in one corner of the globe which in previous times may have had zero impact in other places, today carries potentially high contagion risk and nobody can view themselves as immune from ill winds anywhere.

As I write, Euro-land remains on the brink, banks' balance sheets teetering on the edge should Greece and/or others default, and the US remains in a very challenging economic situation.

On top of this there remains further potential bubbles which could burst at any time; the rate of economic growth in China, the commodity price bubble, etc.

So, we live in a dangerous world financially, and hopefully the Asian markets can learn valuable lessons from observing and understanding the travails of others.

I have seen first hand experience of over ambitious growth, lean capital ratios, imbalanced asset:liability maturity profiles and unsatisfactory risk culture and governance. My conclusion, however, is that the most critical issue in ensuring that a bank is able to withstand the market challenges which inevitably come, is the quality and depth of a bank's people, from top to bottom.

It is a well-worn cliché to say that people are the key asset in a bank, yet the investment in human capital continues to lag a poor second behind financial capital.

We in the iRSQ are doing our bit to try and change that, and we call on like-minded institutions around the world to join with us so that we can truly call ourselves a profession. ✱

■ Angus MacLennan is a career banker whose key roles include serving as a Member of the Executive Committee of Danske Bank with responsibility for Wholesale and International Businesses, and as Co-Head of Merchant Banking at Fortis Bank. Currently, he is Chairman of the Advisory Board at the Institute of Risk Standards & Qualifications (iRSQ), Chairman of An Teallach Energy, Senior Independent Director of Vocalink Holdings, Non-Executive Director of ABC International Bank plc, Senior Advisor to the Board of Nordic Aviation Capital, Senior Advisor to the Board of Isle of Harris Distillery and Vice-Chairman of the Eve Appeal.

CHALLENGES FOR CEOs

IN THE 2011 EDITION OF THE CONFERENCE BOARD CEO CHALLENGE™, CEOs CITED BUSINESS GROWTH AS THEIR NUMBER ONE CHALLENGE AND SAW NEW INNOVATIONS AND MARKETS AS CRITICAL STRATEGIES TO DRIVE THAT GROWTH. THE FOLLOWING ARE HIGHLIGHTS OF THE CONFERENCE BOARD CEO CHALLENGE 2011 FINDINGS.

Tumultuous global events in early 2011 have intensified business challenges faced by companies around the world and steeled CEOs for a more formidable year ahead.

The latest Conference Board CEO Challenge 2011 Survey findings named the top five challenges facing CEOs in Asia, the US and Europe as business growth, talent, cost optimisation, innovation and government regulation. The efforts needed to meet and overcome these five challenges are expected to be nothing short of herculean.

BUSINESS GROWTH: The Most Important Concern

Business growth is touted to be the most important issue currently plaguing companies as CEOs strive to steer their companies back onto the growth track after years of fighting the effects of global weakness. The deep recession of 2008-2009 and the ongoing shifts of production sites from the Western world to emerging markets are key factors affecting business growth.

Meanwhile, talent, cost optimisation and innovation are hailed as clear growth enablers for the top and bottom line. Government regulation, however, sits in the middle of two possible roles – as an obstacle to growth or as an opportunity for innovation and new product lines. As manufacturers eye emerging markets as part of their business growth strategy, service providers are turning to innovation in a move forward.

ASIA: Talent is a Priority

The Asian region is interestingly the only one where business growth doesn't take top priority. Instead finding, keeping and retaining talent has recently emerged as a prime challenge. CEOs must cope with the challenges of aggressive growth targets, rapidly changing business models, workforce demographics and demand for language skills in keeping their talent pipeline flowing.

Asia is also grappling with the challenges of sustainability as well as corporate brand and reputation. Being home to some of the world's fastest growing economies has resulted in its heavy dependence on polluting industries and labour-intensive manufacturing. The negative consequences of these factors have forced governments to take significant regulatory measures to implement a more sustainable growth model that encourages the rewarding of responsible business practices.

Furthermore, corporate brands and reputations are being sullied by the increasing exposures of corporate misconduct thus giving rise to serious reputational issues. Asia has finally grasped that shaking off its negative image as a region producing cheap but shoddy counterfeits is a vital step towards improving its reputation and global competitiveness. The top brand strategy of Asian CEOs therefore is redefining their corporate brand positioning. CEOs of financial services are pushing themselves further by earnestly communicating their corporate values to customers and key shareholders in efforts to solidify the corporate brand and reputation.

Asia

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CONCERN

Government regulation, however, sits in the middle of two possible roles – as an obstacle to growth or as an opportunity for innovation and new product lines. As manufacturers eye emerging markets as part of their business growth strategy, service providers are turning to innovation in a move forward.

EUROPE: Optimising Costs and Growth

Europe's focus meanwhile is trained on business growth and cost optimisation which is reflective of the region's overall economic climate. Despite surfacing relatively late from the global recession, some nations like Germany are seeing robust improvement in the face of slow growth, tax increases and concerns over the health of financial institutions.

The region is also tackling a unique challenge of creating and maintaining customer relationships. In some industries, such as telecommunications, banking, travel and utilities, deregulation and a variety of choices have reinforced the need to enhance loyalty and retention of existing customers. The challenge is further intensified as technology and social media tools give rise to a more sophisticated and demanding clientele. Europe's emphasis on customer relationships may also be related to a desire to reintroduce their companies to consumers.

US: Government Regulation Poses High Risk

In the US, government regulation is being viewed as a challenge but one that has the potential to either obstruct growth or be used as an incentive to boost innovation and opportunity creation. Yet a majority of CEOs worldwide have cited tighter government regulation and intervention in the US as a "very high" risk to the business climate.

SUSTAINABILITY

But the business challenge is how to implement sustainability-centric approaches that respond to customer demand and ecological and social accountabilities while delivering on the financial bottom line. With sustainability as the new nucleus of innovation and value propositions, CEOs are realising that business growth requires more than being first to market with an innovative product.

Sustainability Fuelling Business Growth

A key strategy to fuelling business growth is the development of sustainable products especially in Asia and Europe. Unbridled business growth in Asia has raised enough government concerns for CEOs to pay close attention while Europe faces government mandates for such products and practices. Sustainability in the US however has received a lukewarm response. Although CEOs in the region recognise the need to address the issue, their uncertainty over its execution has led to a decision to keep a cautious distance unless and until sustainability is proven to be a strong contributor to the bottom line.

Undoubtedly, the sustainability trend is making an impact. Demands for such practices and products are steadily changing expectations and creating potential for new markets. But the business challenge is how to implement sustainability-centric approaches that respond to customer demand and ecological and social accountabilities while delivering on the financial bottom line. With sustainability as the new nucleus of innovation and value propositions, CEOs are realising that business growth requires more than being first to market with an innovative product.

Talent Management, Leadership Development and Diversity

In the realm of talent management, CEOs in all three regions are looking beyond mere talent identification and into the strategic application of talent management processes. The consensus is that leadership development should take top priority as an immediate initiative in this direction.

In the Asian job market where qualified and experienced talent is considered scarce and expensive, many CEOs are focusing on maximising impact and developing the skills of the existing workforce.

As a result of Europe's highly diverse and fragmented market, their CEOs are pushing for increased diversity and cross-cultural competencies.

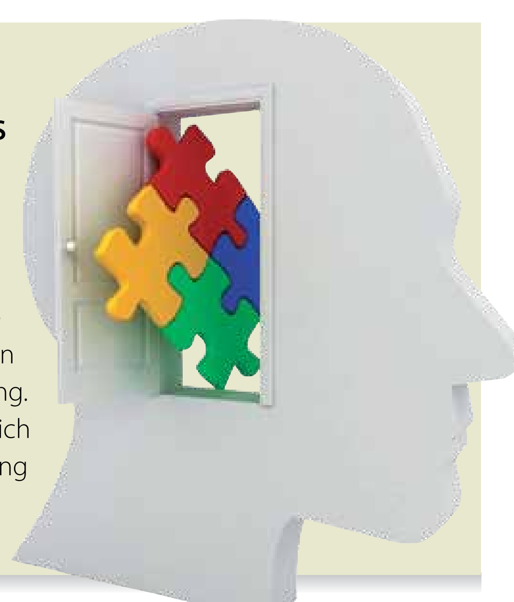
Boosting Productivity

CEOs also view process improvements and boosting employee productivity as critical drivers for cost optimisation and the latter is given special attention in Asia where productivity levels are still well below those of Western countries.

They are also broaching the still new concept of merging technology, culture and talent to meet the dual challenges of cost optimisation and innovation.

THE ROLE OF **INNOVATION**

INNOVATION REMAINS ANOTHER CORNERSTONE OF BUSINESS SUCCESS. One of the main problems CEOs face in building a culture of innovation is employee engagement. The Western mentality of innovation as a simplistic blend of technology and products no longer holds water as real innovation involves rethinking how companies interact and build relationships outside the corporate walls. In acknowledging this, CEOs agree that meeting the innovation challenge will require a mix of technology, talent and alliance building. Companies have begun to catch on that a culture of innovation - which fosters entrepreneurship and risk-taking - is a crucial factor in producing new ideas needed to retain global competitiveness.



Strategies in meeting the former differ according to company size with larger companies depending on business growth and their smaller counterparts leaning on employee productivity.

Regulatory and CSR Pressures

At a time when economic recovery is still fragile, CEOs in the US view the region's highly regulated environment as a potential threat to market position in the next growth phase. The move towards sustainable products and services is expected to be the subject of public forums where government rules are crafted and which will inadvertently impact business growth.

How effectively CEOs respond to government regulations will depend on their strategic motivation and individual time horizons. What is certain however is that the emerging regulatory infrastructure will shape future practices and place new demands on them. While government regulation is a mild challenge for Asia today, there are signs it may soon burgeon into a greater one.

Public-listed companies are feeling the pressure to incorporate environmental, social and governance issues into their companies' annual performance assessments. Across, Asian stock exchanges have begun issuing guidelines aimed at setting minimum thresholds for corporate social responsibility (CSR) best practices and voluntary reporting standards for publicly listed companies.

FUTURE

How effectively CEOs respond to government regulations will depend on their strategic motivation and individual time horizons. What is certain however is that the emerging regulatory infrastructure will shape future practices and place new demands on them. While government regulation is a mild challenge for Asia today, there are signs it may soon burgeon into a greater one.

The survey also found that emerging and developing countries, which accounted for only 40% of global output in 2000, will account for 60% by 2020. Unsurprisingly, China and India are identified as the largest and most dynamic economies with Brazil coming in right behind.

Over 700 CEOs, presidents and chairmen from across geographies and industries identified the most pressing issues they face in today's business environment for The Conference Board CEO Challenge 2011 Survey.

The Conference Board is a global, independent business-membership and research association working in the public interest. Its mission is unique: to provide the world's leading organisations with the practical knowledge they need to improve their performance and better serve society. The Conference Board is a non-advocacy, not-for-profit entity holding 501 (c) (3) tax-exempt status in the United States. ✱

■ Reporting by the *Banking Insight* Editorial Team.

Social Media Trends FOR BANKING

■ CAROL YIP

The last few decades have seen many dramatic shifts in our lifestyles. None is more obvious than the advent of personal computers, cellphones and their effects on the increased levels of social interaction that are taking place. Just about everyone is sharing their thoughts, opinions and experiences with consummate ease: with their friends, family and often strangers. Because of this, social media is changing the way every industry engages with customers right now.

Facebook, Twitter, LinkedIn and YouTube now define today's Internet-driven society. They are hard to ignore; these brands are practically redefining what is meant by the term 'household name'. Unsurprisingly, organisations such as banks are seeking to monetise these massive gatherings of people.

SAP blogger Michael Mischker mentioned that, "strengthening customer loyalty and overall customer experience has become increasingly critical for banks and financial institutions because of the problems they've faced in recent years. A positive experience with bank branches and call centres is still essential. But social media gives banks another arrow in their marketing quivers. Used strategically, it provides a powerful two-way dialogue with customers that can significantly enhance brand and revenue."

Wells Fargo & Co. was the first US bank to launch a corporate blog in March 2006, and the company has since gone on to expand its use of social media to include such innovations as an online role-playing game called Stagecoach Island to make financial education fun for high school and college-

"OUR HEAD OF SOCIAL MEDIA IS THE CUSTOMER." – McDONALD'S

age students. Players can give feedback on new features, chat with other players, share pictures of their avatar, and set up real-time events like birthday parties and ski races. Hundreds of Wells Fargo employees are now using blogs to brainstorm with one another and interact with customers.

The partnership between American Express and Foursquare is a prime example of financial institutions looking to get in on the worldwide social media party. Foursquare is a social networking service where members "check in" at their locations using a mobile phone to earn points and find friends. The deal rewards American Express cardholders with discounts when they check in via Foursquare at participating merchants. This offering is particularly interesting because it combines a financial service, location-based advertising, social media and mobility.

Morgan Stanley will become the first large wealth management firm to give financial advisors access to Twitter. In June 2011, approximately 600 Morgan Stanley employees had full service LinkedIn accounts. Top revenue producers – including members of the "Chairman's Club" – are part of the group allowed to use LinkedIn – the world's most successful professional networking site. By year-end, the firm expects to allow almost 18,000 financial advisors access to LinkedIn and Twitter.

Social media

Used strategically, it provides a powerful two-way dialogue with customers that can significantly enhance brand and revenue.

ASIA'S SOCIAL MEDIA FOR BANKING

An increasing number of banks in Asia are moving into the social media space. A quick survey of bank sites on Facebook returns a surprising number of banks with corporate pages. One of the pages that stood out was POSB in Singapore highlighting its Everyday Champions programme on Facebook. The programme, in collaboration with the Singapore Sports Council, encourages the public to nominate someone they know "that goes the extra mile to promote sports passionately". Central banks in Asia are also getting into the act. Bank Negara Malaysia has an official page on Facebook with information ranging from policy statements to scholarships. Indonesia's Bank Central Asia has a Facebook page that simply directs users to its regular online banking pages. India's ICICI Bank actually provides customer service online by responding to customers' tweets. One of the outcomes of the IDC Financial Insights Asia-Pacific roundtable forum was the "Eight Principles for Social Media in Banking". According to Michael Araneta's blog, although social media presents a new, largely untested way of dealing with customers, it is just another way of dealing with customers. This new channel of customer relationships will call for new practices but the principles of good customer experience and excellent customer service remain unchanged.

USING THE RIGHT SOCIAL MEDIA TOOLS

Banks can learn to influence the collective wisdom of the crowd and build a significant and defensible market position based on solid social media acceptance. The adoption is no longer an 'if' but rather a 'how to' to achieve the desired results for the banks. Here are five reasons how the banks can do it with the right social media tools:

First, banks can widen their brand popularity. While social media marketing holds immense opportunities to positively influence a bank's brand perception, there are some risks that they should be aware of. The most potent risk that many banks have with respect to social media is that the brand image and promise they worked hard to create and spent millions on, is no longer under their control alone and can be destroyed very rapidly before the business can react. This would not only impact new customer relationships but could potentially harm the relationships with loyal customers that the bank took many years to build.

The risk is even higher if the banks decide not to participate in the conversations that are about them. Brands which have worked hard on listening to what its customers are saying and working on improving their brand experience are more likely to continue to get customers to support their brand. Hence, it is imperative that banks have a social media strategy. Social media marketing, if done right, can have a significant impact on brand awareness and popularity.

Banks should use the site or sites that will best help them reach their goals This may involve creating a presence on multiple sites, making best use of each site's strength.

CREATIVE

A bank in Singapore launched a 'Wish List' application, where customers can define their "wishes", and then apply funds to each item as their savings grow. Customers can link it to Facebook to tell their friends what they are saving for and when they have enough to make the purchase. This is a really fun, innovative development that taps into people's drive to achieve personal goals.

Second, banks can engage the public with the products. Given the more personal nature of social media, it could help banks build communities and connect with consumers in a more direct way. For instance, a bank in Singapore launched a 'Wish List' application, where customers can define their "wishes", and then apply funds to each item as their savings grow. Customers can link it to Facebook to tell their friends what they are saving for and when they have enough to make the purchase. This is a really fun, innovative development that taps into people's drive to achieve personal goals. The bank was awarded the CIO Awards by the CIO Asia magazine for its strategic initiatives based on the iPhone device.

Third, banks can get instant feedback from existing and potential customers. One rule of search engine optimisation is to publish a lot of relevant information – and "a lot" refers to volume as well as formats. The algorithms of search engines have been changed so that organisations and products featured in many formats (text, blogs, pictures, news, and videos) lead to more search hits and, thus, are more accessible to prospective customers.

One other advantage of publishing a lot of content is that it allows prospective customers to give feedback, and customer feedback can be looped back into a bank's product and customer engagement strategies. The release of information about a bank's products and services and subsequently mining ideas from customer feedback have been referred to as "baiting" in the banking panels. However, banks need to be prepared to face negative feedback and not be turned off completely from social media.

Fourth, banks can enhance their client relationships. If a bank is truly interested in its relationships with its clients, it must listen to its clients. Not all social media sites are created equal. Each has its own purpose and usefulness. Banks should use the site or sites that will best help them reach their goals. This may involve creating a presence on multiple sites, making best use of each site's strength. It may involve determining whether a bank-wide presence or a relationship manager-based presence is best for each site. But it will always involve listening to clients and determining which social media solution will work best for them.

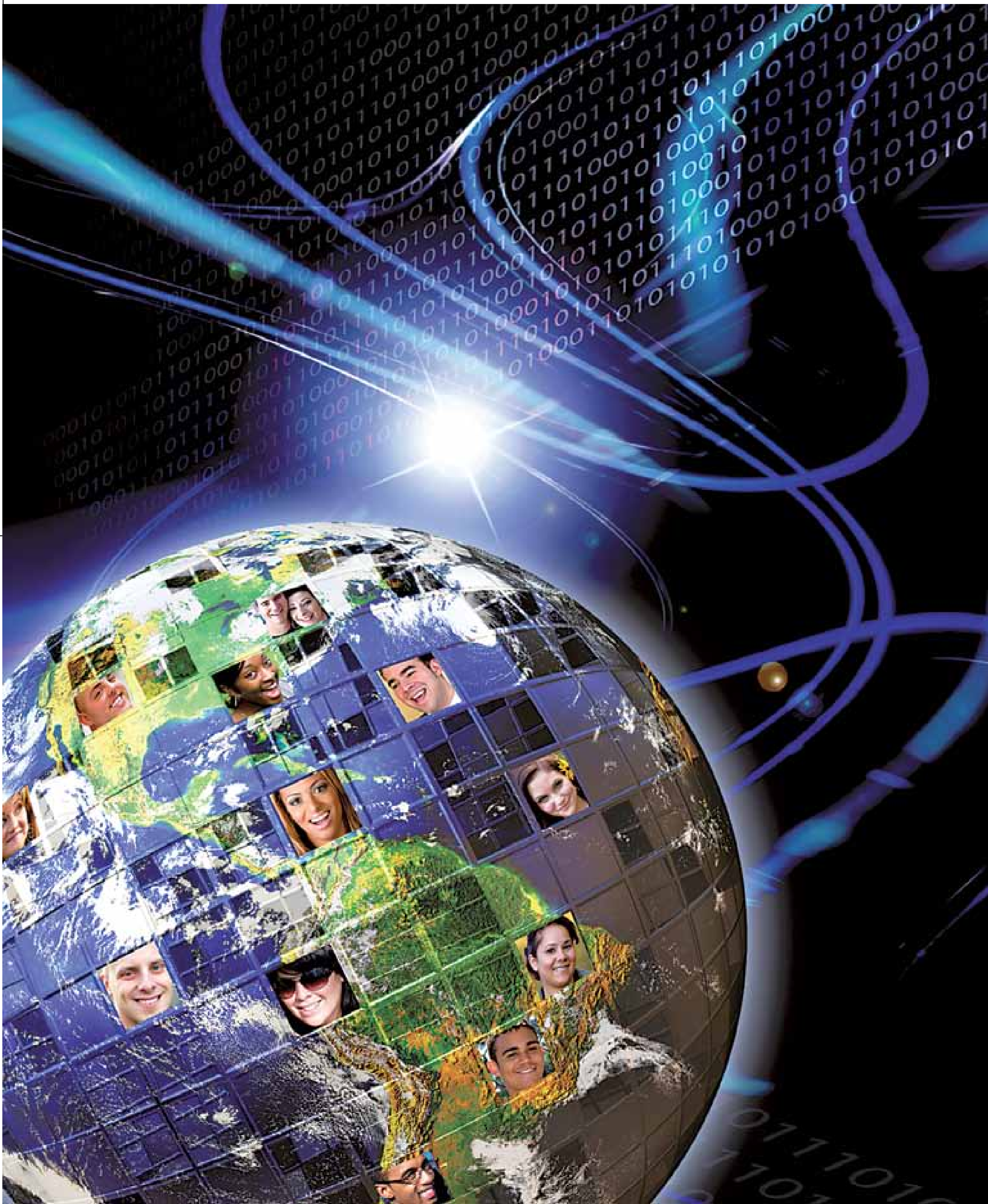
Each client's needs are different. A one-size-fits-all method of social media presence is unlikely to work well. Therefore, a bank's relationship managers need to be well-educated in social media etiquette, in order to get their solutions right every time. And they need to be flexible, adapting to changing client needs and constantly evolving technologies.

Fifth, banks can increase their market share. SAP blogger Michael Mischker commented, "Successful customer relationship strategies driven by social media rely on three components – 'responsiveness' (listening carefully and replying quickly); 'relevance' (keeping responses personal and meaningful) and 'convenience' (interacting with customers at their preferred time and channel)."

If these components are implemented successfully, social media provides a powerful dialogue with existing, new and potential customers that can significantly enhance the banks' brand and revenue because of the platform's viral effect.

At the end of the day, banks must be willing to embrace the new opportunities for collaborative, two-way interactions with customers that social media outlets provide. Not participating in conversations on the social media platform is no longer an option for long-term success of businesses! ✱

■ Carol Yip is a certified financial coach, consultant, advisor and trainer who heads the Abacus For Money team.



HOW BANKS CAN HELP THE PLANET

GREEN MAN **MATTHIAS GELBER** TELLS *BANKING INSIGHT* HOW BANKS CAN BECOME MORE SUSTAINABLE AND GREEN THE EARTH IN THE PROCESS.

How does Matthias Gelber, winner of the Greenest Person on the Planet award from 3rd Whale in Canada in 2008 and champion of sustainability assess Malaysia's progress in becoming green?

"Unfortunately, there is a disconnect between the country's overall ambition, government policy and reality on the ground," said Gelber, Country Manager of the Lifestyles of Health and Sustainability (Lohas) movement in Malaysia. "There is very strong commitment at government level but there are also many bottlenecks along the way."

This is hardly surprising given Malaysia's nascence when it comes to green technology and sustainability. While the government has established a National Green Technology Policy, which includes (among the five thrusts of this policy) the establishment of a National Green Technology Council headed by Prime Minister, Dato' Sri Mohd Najib Tun Abdul Razak, the green movement is still in its infancy.

To strengthen the move towards sustainability, in September, the Ministry of Energy, Green Technology and Water took on the role of key coordinator and facilitator for a green technology roadmap. Its building was the first to be rated a "low energy office" in Malaysia with a reported energy savings of over 50%.

GETTING GREEN TECHNOLOGY UP AND RUNNING

Mindsets will have to change and paradigm shifts made if Malaysia is to succeed in its goal of becoming an advanced nation driven by sustainability and innovation. One of the challenges is the country's reliance on natural resources and on the short-term return on investments those resources have yielded, said Gelber.

Why has green financing not reached the levels targeted by the government in its budget and financial plans? "Green technology is very much a medium to long-term investment which is why banks that haven't been exposed to it are reluctant to finance green technology businesses," he explained. "Moreover such businesses are usually start-ups and the concern a conservative bank will have is over the source of the returns."

"Then there are the people who are used to building a business structure on ventures that are guaranteed to make them money. They aren't ready to make changes either in terms of cost or in using materials that haven't yet been proven effective."

> ***"Malaysia should follow in the UK's footsteps by ensuring that each house has an energy efficiency passport rating before it can be sold. So the value of houses that aren't insulated or eco-friendly shouldn't be allowed to appreciate."***

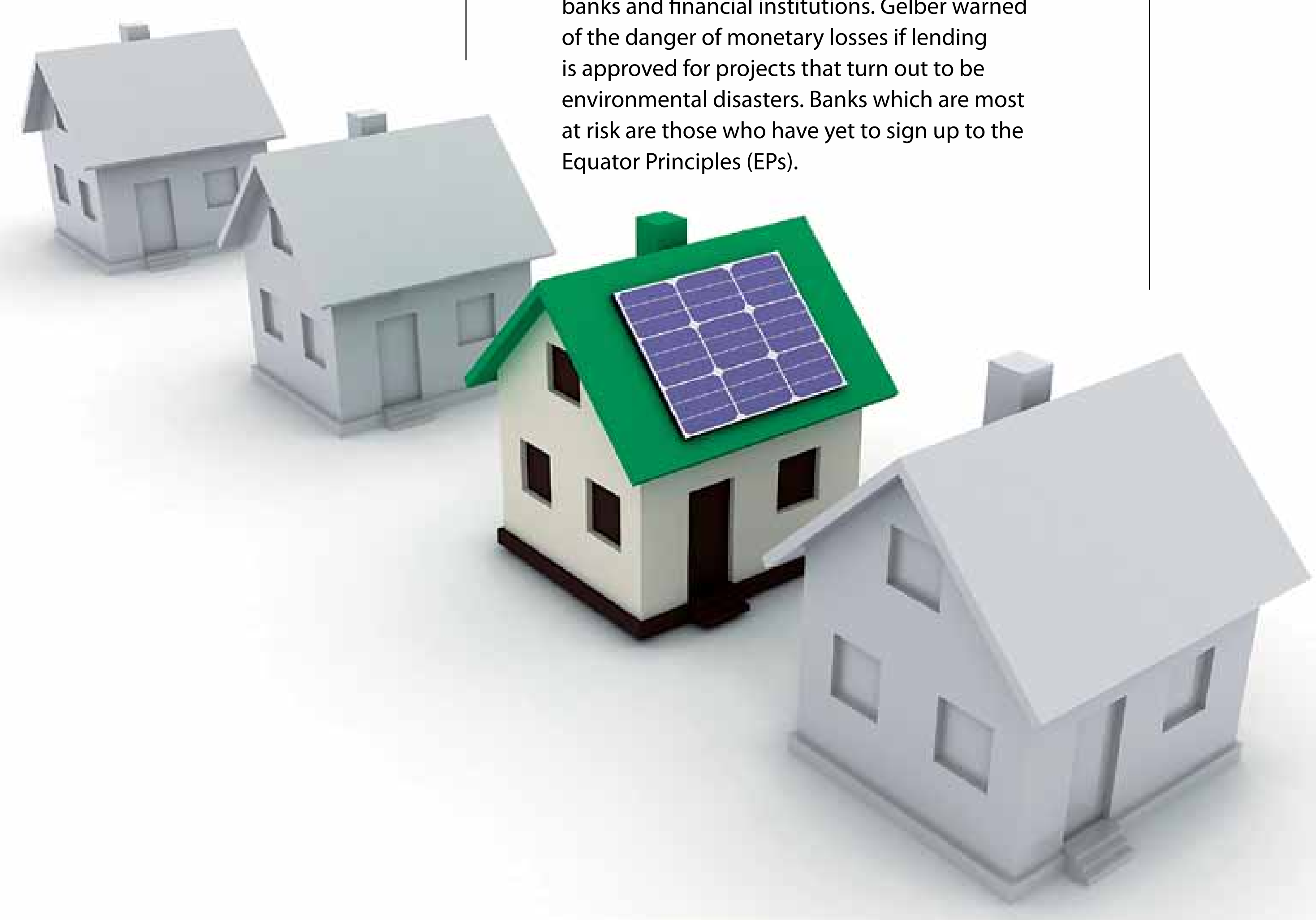
THE ROLE OF BANKS

Gelber emphasised that banks have the potential of being the most powerful driving force in the creation of a green, sustainable nation. His advice to financial institutions is straightforward – become experts in the area of green technology.

One role model is HSBC which Gelber hailed for its proactive approach towards green technology through its recent approval of a green technology funding scheme.

Banks can also help incentivise the adoption of green technology and sustainable lifestyles. For example, "Banks should offer better loan packages for people who buy green homes or hybrid cars," he suggested. "Malaysia should follow in the UK's footsteps by ensuring that each house has an energy efficiency passport rating before it can be sold. So the value of houses that aren't insulated or eco-friendly shouldn't be allowed to appreciate."

Refusing to consider project sustainability can be an area of business and strategic risks for banks and financial institutions. Gelber warned of the danger of monetary losses if lending is approved for projects that turn out to be environmental disasters. Banks which are most at risk are those who have yet to sign up to the Equator Principles (EPs).



The EPs are a credit risk management framework for determining, assessing and managing environmental and social risk in project finance transactions. Based on the International Finance Corporation Performance Standards on social and environmental sustainability, the EPs are primarily intended to provide a minimum standard for due diligence to support responsible risk decision-making.

"The EPs are crucial as a mechanism to avoid massive environmental impacts from mega projects and it is a concern that some domestic banks have yet to sign up to these principles," Gelber stated. "It implies a nonchalance about doing business while adhering to strict environmental criteria. And if that's the case then it's very worrying."

Nevertheless, Gelber lauds banks for their efforts to reduce their carbon footprint, such as taking significant steps to reduce paper usage and even conserve electricity.

"Standard Chartered Bank for example switches off one of its elevators at low peak hours," he recalled. "The temperature is turned up and employees turn off their computers and other electronic equipment when not in use. I also know of banks that are contemplating relocating to green buildings or refurbishing their current offices to meet the green criteria. These are the important decisions that must be included in any bank's roadmap moving forward."

However, Gelber pointed out that security measures can be a double-edged sword in the banks' move to replace paper with electronic options. He noted that a high level of security often led to complications when customers forgot their passwords which then drove them to revert back to conventional banking methods.

"People worry too much about security," he said. "I've never been in danger of falling prey to any online scams but not everyone can detect a scam so education on online security is very important."

ABOUT MATTHIAS GELBER

A professional speaker, international trainer, and businessman, Matthias Gelber emerged as worldwide champion in the award for Greenest Person on the Planet by 3rd Whale in Canada in 2008.

Matthias' passion is in preserving the planet's natural environment – a passion focused on environmental management and CSR for the last 17 years in around 40 countries worldwide.

Earning a Masters in Environmental Science from United Kingdom, Matthias started his own environmental consulting company dealing with sustainability issues related to natural resources. He is co-founder of Maleki GmbH, a company specialising in low carbon footprint and high-performance building materials that won recognition in the Green City Osnabrueck, Germany as the most innovative green SME with high growth potential.

He has served as a board member of INEM (the International Network of Environmental Management) and APRSCP (the Asia Pacific Roundtable for Sustainable Consumption and Production).

EDUCATION, AWARENESS ARE KEYS TO SUCCESS

■ Overcoming these ingrained structures and mindsets is a vital first step in a country where green technology is at its infancy. Gelber therefore recommends focusing on awareness-raising initiatives at government level and in educational institutions.

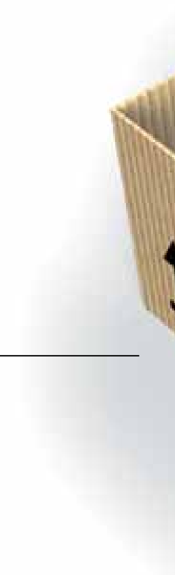
While he acknowledged that attempts are already being made in this regard he added that more intensity and enhancements are needed. "Malaysia has a tendency to hold big events and count the number of people who turn up," he said. "But what we really should be counting is the number of people who are implementing green practices in their lives, who are buying green products and technology or who are offering green business solutions. This should be the prime focus of awareness and education."

The bright spark however is that Malaysia is gradually establishing itself as a leader in the green industry through the International Greentech and Eco Products Exhibition and Conference Malaysia (IGEM). According to Gelber, this has put Malaysia far ahead of its neighbours in the context of policy perspective and ambition.

He pointed out that even Malaysia's Green Building Index is better than that of its neighbours in terms of momentum and traction. "It shows that Malaysia can be a proactive implementer," he said. "The number of certified buildings may not be as high as we'd like but the number of buildings in the pipeline gunning for green certification is quite comprehensive. Malaysia also has one of the best physical incentives given by the government for green building certification and this is an area where the country is close behind Singapore as a leader in the region." ✱

■ Reporting by the *Banking Insight* Editorial Team.

SUSTAINABILITY - UTILISING GREEN TECHNOLOGY AND INNOVATION - HAS BEEN IDENTIFIED AS A KEY PILLAR OF THE MALAYSIAN ECONOMIC TRANSFORMATION GOING FORWARD. *BANKING INSIGHT* EXAMINES HOW BANKS AND FINANCIAL INSTITUTIONS CAN HELP FACILITATE THE GREEN ECONOMY IN MALAYSIA, AND THE POSSIBLE REVENUE DIVERSIFICATION PROSPECTS THAT COULD ARISE FROM GREENTECH FINANCING.



PROMOTING GREENTECH FINANCE

AMIRA ABDULLAH

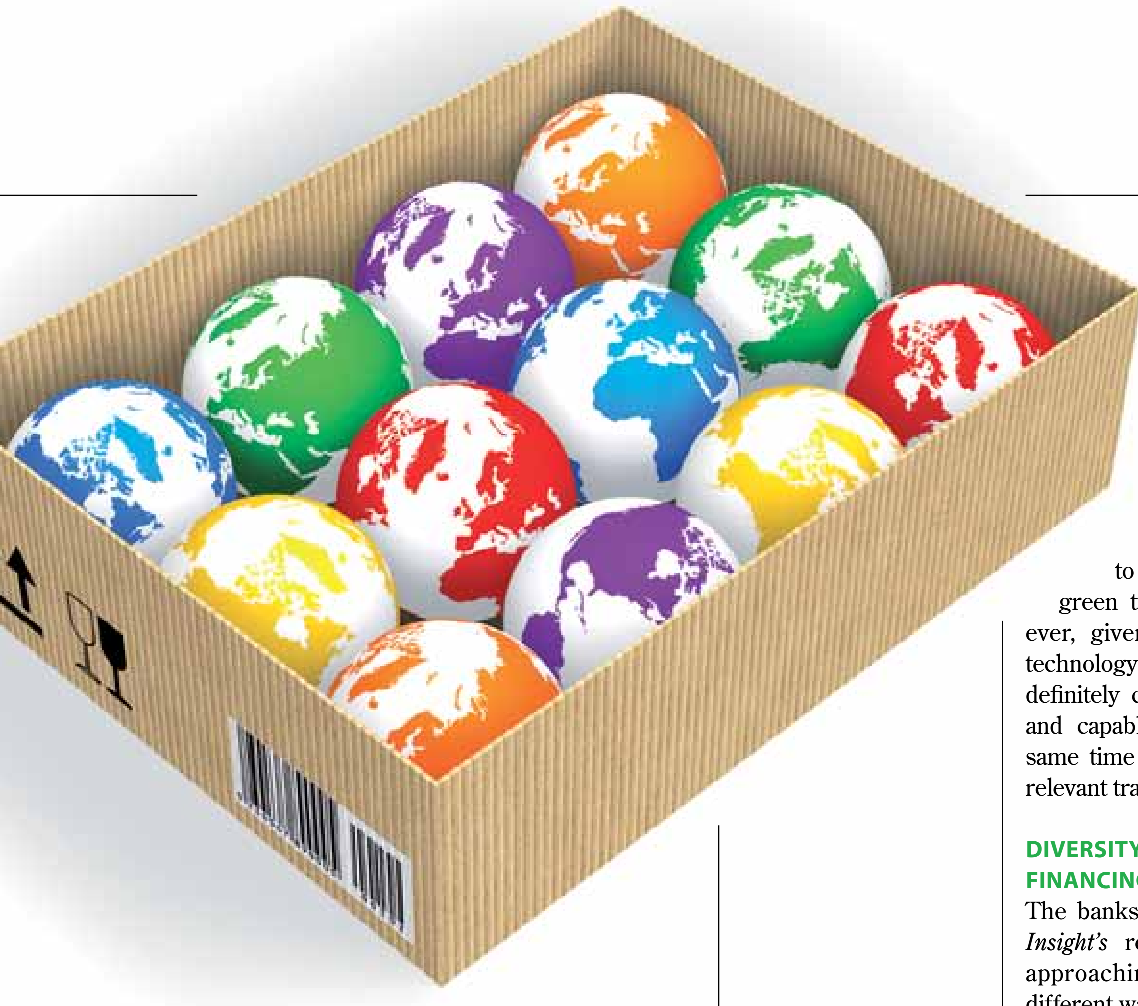
While Malaysia is serious in promoting the green economy, support from certain parties including financial institutions (FIs) for the implementation of such projects needs to be boosted.

Among the targets announced for the government's Green Technology Financing Scheme (GTFS) which took off on 1 January 2010 was that financial institutions would provide 40% of the GTFS financing of RM1.5bn or approximately RM600 million in funding. This target has yet to be achieved as of the time of writing.

To date, only 24 green technology projects have been approved by the banks for financing amounting to about RM350 million, said Dr. Nazily Mohd Noor, CEO, Malaysian Green Technology Corporation (GreenTech Malaysia). The banks that have approved financing for these projects comprise the commercial banks, including Islamic banks, and the development finance institutions.

"The achievement rate is far from expected, in view of the fact that some project developers are not familiar with the credit evaluation requirements for submission of loan applications while some banks are not that conversant with green technology," he commented.

As the driver of the green technology agenda, GreenTech Malaysia is working hard to engage with participants and to address the funding issue. In fact, GreenTech Malaysia is stepping up its efforts to bridge this gap through talks, briefings and pitching sessions to both the applicants/certificate holders (certified by GreenTech) and the banks, said Dr. Nazily. "GreenTech Malaysia will continue and intensify its efforts in promoting awareness on the scheme to increase the take up rate," he said.



Does greentech financing require a new skillset? In the aspect of skills and expertise, Adissadikin feels that it is still too early for him to say that Exim Bank has the people with the right skill and expertise needed to address the development of green technology financing. "However, given the importance of green technology moving forward, we would definitely consider employing qualified and capable candidates, whilst at the same time we will send employees for relevant training," he added.

NOT A NEW FINANCING MODEL

Adissadikin Ali, Managing Director and Chief Executive Officer, Export Import Bank of Malaysia Bhd (Exim Bank) said greentech is an extension to established sectors such as manufacturing or construction. The only difference is that the materials, processes and the end-products of such sectors contribute to lowering carbon emissions and minimising environmental degradation.

Hence, the challenges for financiers are to understand the technical part of the green technology involved and how to structure the financing terms in an effort to encourage the business community to go green, given the limitations of the respective FIs.

As such, Adissadikin does not see the necessity to change the current business model structure of Exim Bank as it does not deter the development of green technology finance. "There is no specific type of financing that is deemed as suitable for greentech finance. This is due to the fact that all types of financing are relevant based on the applicants' requirement. We also do not foresee any significant variances on the yield from green technology finance as opposed to Exim Bank's other types of financing," he added.

Hence, the challenges for financiers are to understand the technical part of the green technology involved and how to structure the financing terms in an effort to encourage the business community to go green, given the limitations of the respective FIs.

DIVERSITY OF GREEN FINANCING PROJECTS

The banks that responded to *Banking Insight's* requests for interviews are approaching greentech finance in different ways.

Adissadikin said Exim Bank planned to disburse between RM100 million and RM150 million to finance a diversity of green projects externally. The projects included the construction of sewerage treatment plants in Syria, construction of biomass power plants in Thailand and wastewater management plants in Vietnam. "We are currently evaluating loan applications for the construction of public housing projects using the industrialised building systems (IBS) concept in a few countries in South Asia, the Middle East and Australasia," Adissadikin said.

Meanwhile, Maybank Group's area of focus is investment in clean energy and it recently launched a private equity fund for the clean energy sector. The fund, Maybank MEACP Clean Energy Master Fund, will prioritise investments in power generation infrastructure projects using renewable sources and will not be targeting investments in clean technology or carbon trading.

The Green Technology Financing Scheme – An Update

Green technology and sustainability received a boost when Prime Minister Dato' Sri Mohd Najib Tun Abdul Razak announced the establishment of the RM1.5bn Green Technology Financing Scheme (GTFS) in his Budget speech for 2010. The scheme was envisioned to benefit companies who are producers and users of green technology.

As a sign of commitment, the government would bear 2% of the total interest/profit rate. In addition, the government would provide a guarantee of 60% on the financing amount via Credit Guarantee Corporation Malaysia Berhad (CGC), with the remaining 40% financing risk to be borne by participating financial institutions (PFIs).

The Prime Minister also appointed Green Technology Corporation Malaysia (GreenTech) as the conduit for GTFS applications.

GTFS's Progress

Since the establishment of the GTFS in 2010, a total of 123 applications have been successfully processed of which 103 projects certified green amounting to RM2.1bn. Out of the 103 projects approved, 60 projects are from the energy sector, 32 from water and waste, six from buildings and five from the transportation sector.

Currently, a total of 31 projects are being processed out of which nine green projects are in the advanced stages and are expected to be approved soon while the remaining 22 are in the process of documentation completion, said Dr. Nazily Mohd. Noor, CEO, GreenTech Malaysia.

Thus far, the approved projects are in line with the National Key Economic Areas (NKEAs) particularly in the energy, palm oil and electrical and electronics sectors.

We have to come up with a green technology roadmap for the country to help prepare policies for the government.

Criteria for GreenTech Certification

During the green technology project evaluation process, one of the major factors to be considered by GreenTech Malaysia was the amount of carbon emission reduction, said Dr. Nazily.

Another major factor is the "bankability" of the project. For this purpose, the applicant is required to do a presentation to a group of banks who will then rate the project in terms of its "bankability".

Upon being awarded the Green Technology Certificate, the project developer may approach any commercial bank or development financial institution to apply for financing under the GTFS. The viability of the project will be assessed by the respective banks in accordance to their internal credit policies.

Dr. Nazily Mohd. Noor, CEO, GreenTech Malaysia.

Roadmap Needed

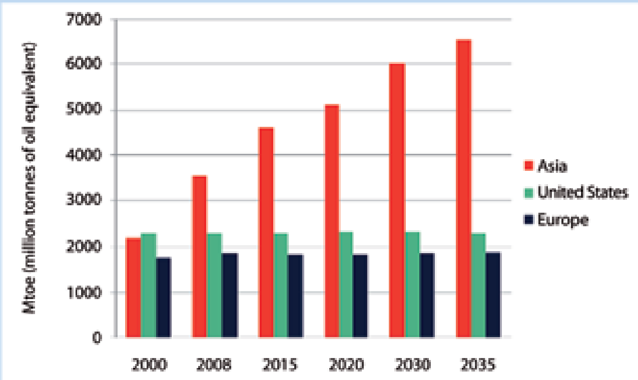
Education and training are a key part of GreenTech's agenda to create a sustainable mindset. To achieve this, GreenTech is raising awareness of how green technologies permeate through different sectors, including energy, building construction, transportation, ICT, water and waste management industries utilising platforms such as roadshows and media.

"We have to come up with a green technology roadmap for the country to help prepare policies for the government," said Dr. Nazily. "Our corporation is required to promote [the use of green technology], so we have to train people."

In the pipeline is an academy to train government staff and the private sector.

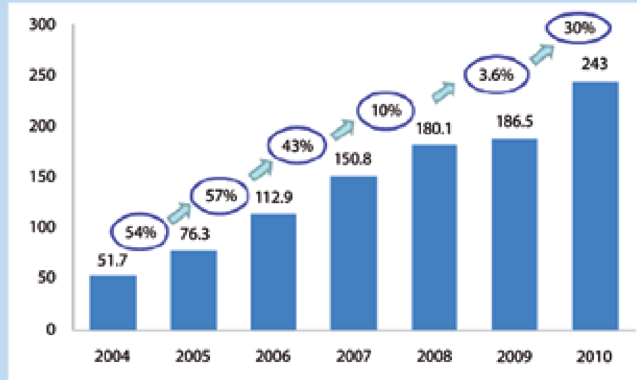
"GreenTech is also going to offer a consultancy service in the areas of energy saving, green townships, carbon and water footprint calculation and ICT," said Dr. Nazily.

Figure 1: Actual and Forecasted Energy Demand by Region



Source: World Energy Outlook 2010, International Energy Agency (IEA).

Figure 2: Global Investments in Clean Energy (US$ bn)



Source: Bloomberg New Energy Finance, 2010.

Tengku Zafrul Tengku Aziz, CEO, Maybank Investment Bank said the fund has a geographic focus across Asia in sectors such as wind, solar, geothermal, small hydro, biomass, biofuels and waste-to-energy. The funding will be primarily used for expansion capital for established clean energy companies and green field projects.

According to Tengku Zafrul, the Maybank Group has committed USD50 million to the fund. The fund currently has a total commitment of USD87.5 million and the target is to raise the fund size to USD500 million from third party sources. It aims to disburse the funds to suitable companies within the next five years and to deploy between 10% and 20% of the total funds committed to suitable Malaysian companies.

Tengku Zafrul said the main challenges and issues in funding clean and renewable power generation projects are akin to those involved in infrastructure-type financing. Specifically, ensuring that project sponsors' interests are aligned to the investors, that the source of energy generation is sustainable, and that continuous support from the government exists in this space are key to the success of these projects.

He said Maybank has sufficient skills and expertise necessary for green technology finance as the fund is focused on infrastructure-like projects, which the bank has a long history of providing. "There is a dedicated team to the fund, all of whom have extensive experience in clean energy and infrastructure-type investments," he elaborated.

PROSPECTS

Tengku Zafrul sees ample opportunities in green technology finance as Asia has the fastest growing demand for energy, and clean energy is a high growth sector. "Asian governments are prioritising policy guidelines and incentives for achieving clean energy targets. A broad range of clean energy sub-sectors provide in-built diversification. Clean energy in Asia is a rapidly growing infrastructure asset class with multi-faceted opportunities."

"Stable long-term cash flows which are asset-backed with strong contractual off-take arrangements make Asian clean and renewable energy a preferred infrastructure asset class. Carbon credits provide additional hard currency revenues and further enhance project returns," he said.

"Maybank believes the clean energy industry is growing exponentially and is expected to continue to grow over the next decade," he added.

Likewise, Adissadikin too is certain of huge opportunities for growth in this sector, against the backdrop of heightened awareness and concerted efforts in pushing the green agenda. "Hence, given the importance placed on green technology, we will explore ways to develop and better position our financing facility in addressing the development of this sector," he said.

GREEN CORPORATE CITIZENSHIP

Furthermore, as Malaysia matures, stakeholders are placing higher expectations of good corporate citizenship on business, including financial institutions. Supporting green technology and sustainability is one means for banks to be socially responsible.

In this vein, Exim Bank acknowledges that it is becoming more responsible towards sustainable development, and green technology financing enables the bank to pursue its corporate social responsibility (CSR) agenda. "This is part of our effort in paving the way for Malaysian companies to influence positive changes," said Adissadikin.

Similarly, Maybank acknowledges that green technology finance is a way for the bank to carry out its business whilst still being a responsible corporate citizen, complementing its CSR agenda that focuses on various initiatives ranging from youth development to community engagement to preserving the environment. ✱

■ Amira Abdullah is a senior freelance journalist based in Kuala Lumpur.

The importance OF ERM IN FINANCIAL INSTITUTIONS

■ RAMESH PILLAI

Continuing increases in the scale and complexity of financial institutions and in the pace of their financial transactions demand that they employ sophisticated risk management techniques and monitor rapidly changing risk exposures. At the same time advances in information technology have lowered the cost of acquiring, managing and analysing data, and have enabled considerable and ongoing advances in risk management at institutions worldwide. Banks in many emerging market countries are also increasing their focus on risk management in an effort to build more robust and sound financial systems, to remedy weaknesses that were exposed by recent regional and international problems, and to position themselves to participate more fully in the global economy.

Because taking risks is an integral part of the banking business, it is not surprising that banks have been practicing risk management ever since there have been banks - the industry could not have survived without it. The only real change is the degree of sophistication now required to reflect the more complex and fast-paced environment.

The global financial crisis illustrated the potential benefit of more sophisticated risk management practices. Many banks did not adequately assess their exposures to the full gamut of enterprise risk. Institutions seemed to have assumed that stability would continue internationally and failed to consider what might happen if that were not the case. A greater willingness and ability of banks to subject their exposures to stress testing could have highlighted the risks and emphasised the importance of key assumptions. Had they conducted stress tests, some lenders might have seen how exposed they were to changes in market conditions or to an interruption of steady economic growth.

Although avoiding failure is a principal reason for managing risk, global financial institutions also have the broader objective of maximising their risk-adjusted rate of return on capital, or RAROC. This means not just avoiding excessive risk exposures, but measuring and managing risks relative to returns and to capital. By focusing on risk-adjusted returns on capital, global institutions avoid putting too much emphasis on activities and investments that have high expected returns but equally high or higher risk. This has led to better management decisions and more efficient allocation of capital and other resources. Indeed, bank shareholders and creditors expect to receive an appropriate risk-adjusted rate of return, with the result that banks that do not focus on risk-adjusted returns will not be rewarded by the market.

Returns/ Risks

By focusing on risk-adjusted returns on capital, global institutions avoid putting too much emphasis on activities and investments that have high expected returns but equally high or higher risk.

Risk management is clearly not free. But the cost of delaying or avoiding proper risk management can be extreme: failure of a bank and possibly failure of a banking system. A point too often overlooked, however, is that, by focusing on risk-adjusted returns, risk management also contributes to the strength and efficiency of the economy. It does so by providing a mechanism that is designed to allocate resources - initially financial resources but ultimately real resources – to their most efficient use. Projects with the highest risk-adjusted expected profitability are the most likely to be financed and to succeed. The result is more rapid economic growth. Without sound risk management, no economy can grow to its potential.

Stability and greater economic growth, in turn, lead to greater private savings, greater retention of that savings, greater capital imports and more real investment. All this, form sound risk management. Without it, not only do we lose these gains, but we also incur the considerable costs of bank disruptions and failures that follow from unexpected, undesired and unmanaged risk-taking.

Had they conducted stress tests, some lenders might have seen how exposed they were to changes in market conditions or to an interruption of steady economic growth.

FUNDAMENTALS

There must also be adequate accountability, clear lines of authority and separation of duties between business functions and those involved in risk management and internal control. These elements, and others, are time-tested fundamentals of risk management that do not entail high technology or complex risk measurement techniques.

There are also prerequisites for banks to develop the ability to measure and manage risk effectively. First, in order to measure risk, the country must have solid accounting and disclosure standards that provide accurate, relevant, comprehensive and timely information so that banks can assess the condition and performance of borrowers and counter parties. To ensure accuracy, accounting systems need to be supplemented by auditing systems and backed up by enforceable legal penalties for providing fraudulent or misleading information to government agencies and outsiders. Banks also need reliable information on the credit history of potential borrowers and on macroeconomic and financial variables that can affect credit and other risks. Additionally, banks need staff with sufficient expertise in risk management to identify and evaluate risk.

Implicit in most methods of evaluating credit risk is the assumption that the probability of repayment depends on the ability of the borrower to repay, in other words, that willingness to repay is not the issue. If repayment depends on whims, then its probability is difficult if not impossible to assess. Thus, an adequate legal system and "credit culture", in which borrowers are expected to repay and are penalised if they do not, are yet further prerequisites for sound and accurate risk management. The ability to seize the collateral of borrowers who default is essential if banks are to have the incentives and ability to mitigate risk. Without the legal infrastructure - the laws, courts and impartial judges - necessary to enforce financial contracts in a timely manner, much of risk management would be for nothing, once the initial decision to extend credit is made.

Finally, the potential for conflicts of interests in risk management must be limited. In particular, regulations are needed that restrict and require disclosure of connected lending to bank owners, shareholders or management. Without such regulations, the desire for personal gain may distort the incentives of bank owners and managers to manage risk appropriately.

The fundamental elements of sound risk management are easy to describe in the abstract but are far more difficult to apply case-by-case. Each situation is unique, built around the roles and capabilities of individuals and the structure, activities and objectives of the institution. What works for one firm may, of course, be unsatisfactory for another. Moreover, in the context of a particular firm, the definition of a sound or adequate risk management system is ever changing, as new technology accommodates innovation and better information and as market efficiency grows. To remain competitive, institutions must adapt and constantly improve their processes. That fact becomes clearer every day.

Apart from those contingencies, however, certain basics apply quite generally. In any institution, support for crucial programmes must come from the top. Each entity's senior management and governing board must set the institution's risk appetite by establishing standards, and by ensuring that they are followed and enforced. Throughout the institution, risks must then be measured, monitored and reported to key decision-makers.

While the complexity and formality may vary widely among institutions, each firm should have clear procedures for assessing risk and evaluating performance over time. There must also be adequate accountability, clear lines of authority and separation of duties between business functions and those involved in risk management and internal control. These elements, and others, are time-tested fundamentals of risk management that do not entail high technology or complex risk measurement techniques.

I very much fear that institutions throughout the world view risk management - often "sophisticated risk management" - as a Holy Grail, without having a real understanding of its fundamental elements and how difficult it can be to impose them. This, I believe, is particularly true in developing countries with traditions or cultures that emphasise

MANAGING RISK

Risk means variability, and leveraged institutions like banks have little tolerance for loss. That is why banking institutions must reduce and manage risk exposures, think of yields on a risk-adjusted basis, and realise that financial leverage can magnify the impact of losses as well as gains.

relationships more than legally enforceable obligations. Moreover, even for organisations that operate in a culture - such as the United States - that is more risk-oriented, risk management techniques can threaten traditional ways and thoughts. Managers who are already in important decision-making posts and staff who do not yet have the technical skills necessary for risk management are especially likely to find change disruptive, mechanical and lacking in the all-important qualities of judgement and experience that they, of course, already have in considerable abundance. Do not misunderstand me. I am not an opponent of experience and judgement, and I do believe that building a risk management system that is designed to be automatic is foolhardy. My point is that change is difficult at any institution or set of institutions. It is even more difficult if the change is not consistent with the cultural and institutional environment and/or the skills of the management and staff.

Difficulty with staff expertise is why the first steps for effective risk management probably should be the least technical and the ones with the best chance for payoff in the short run. I am thinking of accountability, clear lines of authority and responsibility, and - to avoid conflicts of interest – the crucial separation of business line management from risk management and internal control. As I noted earlier, the latter alone could have saved Barings.

The next step, I suggest, is to begin thinking about returns in terms of the risk-return nexus, the RAROC I noted earlier. Just that simple way of thinking about an investment decision goes a long way in improving risk management. The best deal - especially for leveraged institutions like banks – is hardly ever the one with the best rate of return. Rates of return are provided to compensate for risk. If rates of return are high, it is because they are compensating for a high level of risk. Risk means variability, and leveraged institutions like banks have little tolerance for loss. That is why banking institutions must reduce and manage risk exposures, think of yields on a risk-adjusted basis, and realise that financial leverage can magnify the impact of losses as well as gains.

A critical concern in developing a basic risk management process involves developing or attracting personnel with the skills necessary to apply risk management tools in meaningful ways. Risk management implies significant limits on the ability of highly leveraged financial institutions such as banks to provide badly needed venture capital; it implies that financial systems need more than banks. They need non-bank financial institutions that are less leveraged than banks and have much longer term liabilities. They also need functioning capital markets, including foreign providers of long-term and equity capital. These other elements may constrain local banks, but they bring blessings, too. They create instruments and institutions that are stronger, more diversified and easier to manage during periods of financial stress. They also provide greater stability to financial systems and alternative funding sources for borrowers.

Indeed, this may be a lot to load onto such a seemingly small concept as risk management, but the concept is not really so small. It is fundamental to sound banking and requires a revolution in many of the institutions' banking systems. Risk exists and banks must accept risk if they are to thrive and meet an economy's needs. But they must manage the risks and recognise them as real. Risk matters. Whether or not it is temporarily ignored, it will eventually come out. Recognising that fact and dealing with it will benefit lending institutions and the economies in which they operate. Indeed, given globalisation, we must all adopt increasingly sophisticated risk management practices in the years ahead. ✱

■ Ramesh Pillai is Chairman of the Board of Governors, Institute of Enterprise Risk Practitioners.

LIQUIDITY MANAGEMENT IN *Islamic Finance*

LIKE OTHER SECTORS OF BUSINESS, ISLAMIC FINANCE TOO NEEDS ADEQUATE LIQUIDITY TO FUNCTION. WHAT ARE THE ISSUES AND CHALLENGES FACING ISLAMIC FINANCE IN TERMS OF LIQUIDITY AND HOW ARE THESE BEING MANAGED?

Liquidity is the lifeblood of any business," said Daud Vicary Abdullah, President and Chief Executive Officer, INCEIF at the recent 17th MIA-AFA Conference in Kuala Lumpur. And what liquidity management boils down to is "managing the asset-liability mismatch," he continued.

Why is liquidity management specifically important? For financial institutions, it means being able to manage cash commitments at short notice, avoiding raising funds at a premium, and from the regulatory perspective, satisfying statutory liquidity and reserve requirements, commented Anita Menon, Executive Director, Advisory, Financial Risk Management Services, KPMG Malaysia, who also sits on the KPMG Global Islamic Finance Working Group. Menon was speaking at the same Conference on the topic of liquidity management in Islamic finance.

"There are consequences if liquidity is not managed and liquidity risks can have a knock-on effect, especially where reputation is concerned. This (impaired reputation) leads to further exacerbating the situation by significantly increasing the cost of funds, and can have a further contagion effect, a ripple effect on the banking system," said Menon.

"Especially for Islamic financial institutions, by virtue of their structure, they face a huge mismatch in their funding and financing maturities," she continued.

Challenges in Islamic Liquidity Management

● Menon noted that there are several reasons constraining Islamic banks in terms of liquidity management.

One is a lack of cross-border liquidity, which "limits Islamic banks' capacity to compete with conventional international banks."

Two is the lack of an Islamic interbank market, with very few highly-rated *sukuk* for example. "There are hardly any liquid assets to hold on to especially with no other alternatives such as *Shariah*-compliant papers or instruments to invest in," she elaborated.

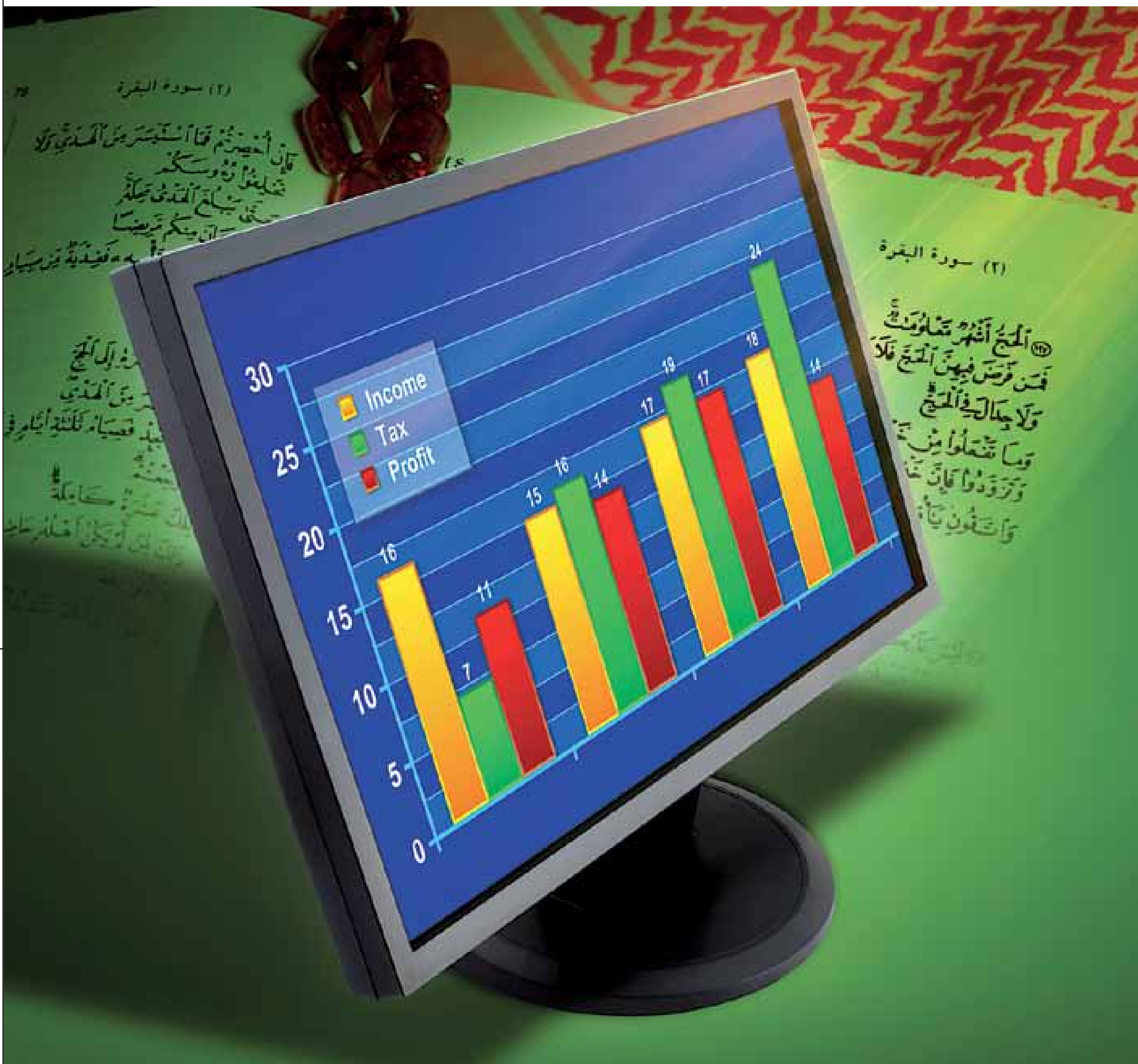
Three is a lack of product standardisation. "Internationally, or sometimes even within national borders, we see a lack of common product features and legal contracts on which asset transfers can be based," she added. "There is a need to move towards more cooperation between regulators and jurisdictions to resolve this."

Important

Being able to manage cash commitments at short notice, avoiding raising funds at a premium, and from the regulatory perspective, satisfying statutory liquidity and reserve requirements.

CHALLENGES

The limited availability of *Shariah*-compliant instruments in many jurisdictions pose substantial challenges for efficient and robust liquidity management. Demand for liquidity instruments continues to outstrip supply, both at national and global levels. The supply of tradable and sovereign instruments that can be held for liquidity purposes has also been limited.



She added that the limited availability of *Shariah*-compliant instruments in many jurisdictions pose substantial challenges for efficient and robust liquidity management. Demand for liquidity instruments continues to outstrip supply, both at national and global levels. The supply of tradable and sovereign instruments that can be held for liquidity purposes has also been limited.

Related to this are the high costs and low volume of transactions. "The secondary market trading of these instruments involves high transaction costs and, if and when it does happen, wide bid-ask spreads, while the trading has remained shallow."

There is also a build-up of cash. "There are unnecessarily large holdings of cash by most international Islamic finance institutions to meet their short-term and liquidity needs – and these have implications as far as their return on investment is concerned – and to mitigate their liquidity mismatch risks," said Menon.

Getting Ready for Basel III

● Basel III will come into play in 2013 and will become effective in 2019. "Most banks in Malaysia are just coming to grips with Basel II, and now on the back of it they have Basel III to contend with," said Menon.

One of the core areas under Basel III is liquidity reform, which among other things covers two ratios – the short-term Liquidity Coverage Ratio (LCR) and the long-term Net Stable Funding Ratio (NSFR). These will come into play in 2013 and will become effective in 2015. "The timeline is quite short, so banks should be preparing in order to comply with the liquidity ratios," she said.

To meet the short-term LCR means a bank's ratio of high quality liquid assets (HQLA) to total net cash outflows over the next thirty calendar days should exceed 100%. While there is a shortage of HQLA *Shariah*-compliant liquid assets – such as AAA-rated papers – the establishment of the International Islamic Liquidity Management Corporation (IILM) is intended to mitigate this.

Islamic banks will have a bigger challenge meeting the long-term NSFR, where the ratio of the available amount of stable funding to the required amount of stable funding should exceed 100%. Islamic financial institutions (IFIs) don't have longer-term liabilities, worsened by the lack of short-term liquid instruments and profit-sharing investment accounts (PSIA) that can be withdrawn at short notice. As a result, many of the IFIs need cash buffers which can be an expensive exercise, said Menon.

Developments in Islamic Finance Liquidity Management

● Several initiatives have been put forward to address the challenges that face Islamic financial institutions, said Menon, namely the International Islamic Liquidity Management Corporation (IILM), the International Islamic Financial Market (IIFM) and the Liquidity Management Centre, (LMC) Bahrain.

The IILM was established by twelve central banks and two multilateral organisations. Its primary objective is to issue *Shariah*-compliant financial instruments in order to facilitate more efficient and effective liquidity management solutions for institutions offering Islamic financial services, as well as to facilitate greater investment flows of *Shariah*-compliant instruments across borders. IILM will address key fundamental issues facing the industry, namely the lack of short-term liquid instruments for IIFM and the absence of a robust liquidity management infrastructure.

ISSUE

IILM will address key fundamental issues facing the industry, namely the lack of short-term liquid instruments for IIFM and the absence of a robust liquidity management infrastructure.

The IIFM on the other hand is primarily focused on the standardisation of Islamic financial products, documentation and related processes. The IIFM has introduced the *Tahawwut* (Hedging) Master Agreement with the International Swaps and Derivatives Association (ISDA) which provides the industry with a framework for entering into hedging arrangements, "However, it has yet to be accepted by all *Shariah* boards," noted Menon, since there are concerns with "what is acceptable and what is permitted."

Meanwhile, the LMC works to facilitate the investment of surplus funds of Islamic banks and financial instruments into quality short and medium-term *Shariah* compliant financial instruments. This will help assuage demand by ensuring a larger pool of liquidity instruments. ✱

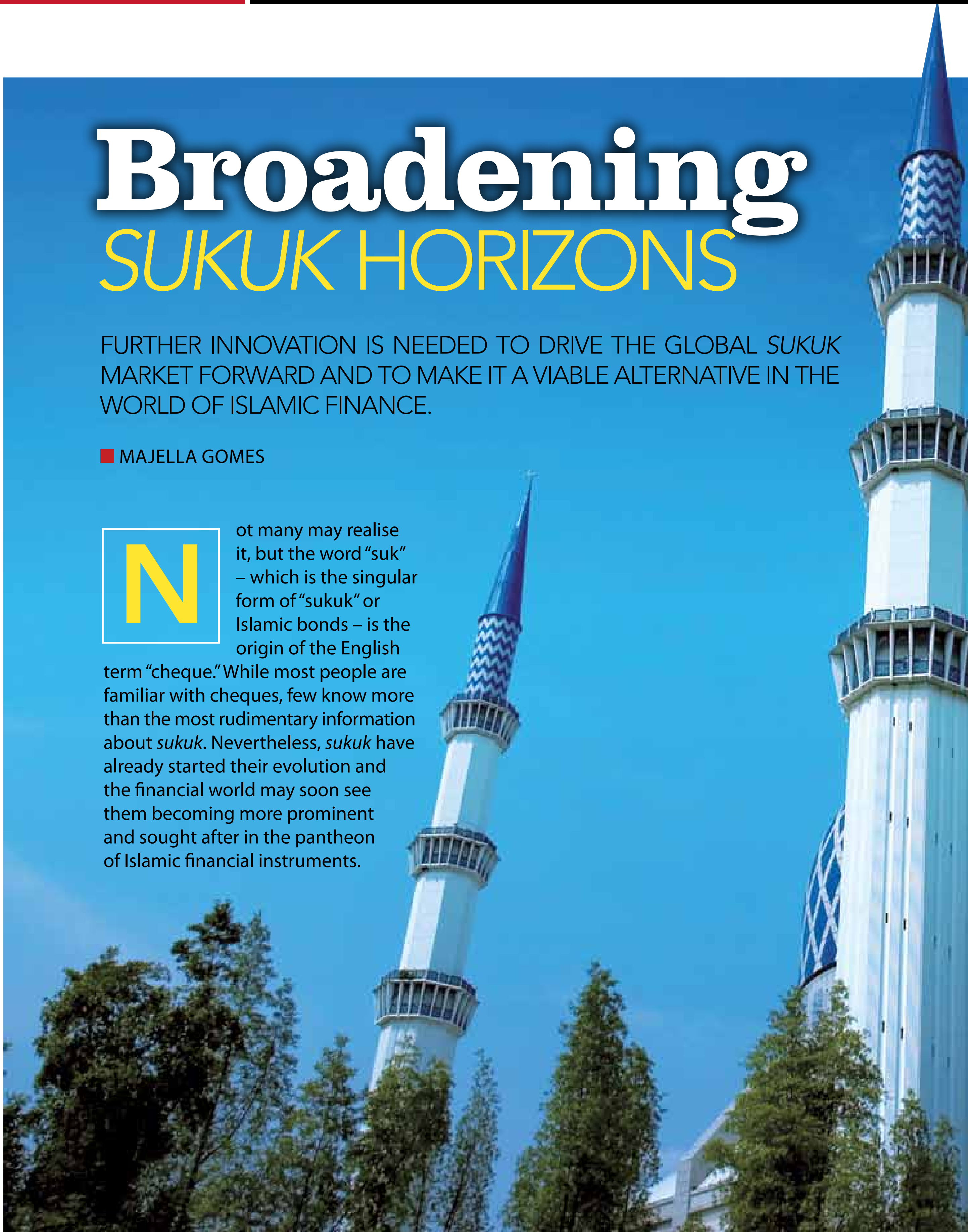
■ Reporting by the *Banking Insight* Editorial Team.

Broadening *SUKUK* HORIZONS

FURTHER INNOVATION IS NEEDED TO DRIVE THE GLOBAL *SUKUK* MARKET FORWARD AND TO MAKE IT A VIABLE ALTERNATIVE IN THE WORLD OF ISLAMIC FINANCE.

MAJELLA GOMES

Not many may realise it, but the word "suk" – which is the singular form of "sukuk" or Islamic bonds – is the origin of the English term "cheque." While most people are familiar with cheques, few know more than the most rudimentary information about *sukuk*. Nevertheless, *sukuk* have already started their evolution and the financial world may soon see them becoming more prominent and sought after in the pantheon of Islamic financial instruments.



The innovations and challenges of the *sukuk* market were among the technical topics being covered at the recent MIA-AFA International Conference. Although the focus was on *Sukuk ALIm* or *Sukuk al-Amanah Li al-Istithma*, a unique offering by the Malaysian national mortgage corporation Cagamas, the speakers covered other aspects of the *sukuk* market as well, especially its potential in hitherto untapped sectors like the Middle East.

Remarking that *sukuk* was currently a hot item, Session Chair Dr. Mohamed Akram Laldin said that Malaysia is at present the biggest issuer of *sukuk* globally. "But further innovation is needed if the market is to move forward," added the Executive Director of the International *Shariah* Research Academy for Islamic Finance (ISRA) Malaysia. He later suggested, in the course of the panel discussion, that one way of doing this may be to institute rating standards for *sukuk*, to make it more attractive for investors.

PIONEERING ALIm

● Rafe Haneef, Chief Executive Officer, HSBC Amanah Malaysia Berhad, drilled down to details of *Sukuk al-Amanah Li al-Istithma (ALIm)*, which is widely considered one of the most outstanding innovations in recent times, in what has been, until now, a relatively tame and uneventful market. What made *Sukuk ALIm* shine was perhaps its structure which, while adhering strictly to *Shariah* principles, did not include *Inah* (sale and buy back), *Bai'Dayn* (debt trading), *Tawarruq Munazzam* (pre-arranged transaction between multiple parties) and *Wa'ad* (undertaking). Issued on 13 July 2010, *Sukuk ALIm* was priced at a yield of 3.48% for a tenure of three years.

A bond is essentially a fixed-income instrument which gives a payment periodically.

"A bond is essentially a fixed-income instrument which gives a payment periodically," explained Haneef. "The government of Malaysia has raised money from the public before, through the issuance of bonds, giving the undertaking to make payments every quarter to the bondholders, over a certain number of years. *Sukuk ALIm* was launched under Cagamas' Islamic Commercial Paper and Islamic Medium Term Note programmes, and was jointly developed with Saudi Arabian bank Al-Rajhi, the first-ever collaboration of its kind."

Perhaps what has caused a stir in the usually staid world of Islamic bonds is not so much *Sukuk ALIm* itself, as what its debut portends. The involvement of Al-Rajhi was significant in that it was the first time the Saudi Arabian bank had ever been involved in such an issuance. Steven Choy, President and Chief Executive Officer, Cagamas Berhad, explained that the National Mortgage Corporation started with "plain vanilla" *sukuk* structures, then gradually developed more complex ones, including mixed assets and commodities. "*Sukuk ALIm*, with an issuance size of RM1bn, is 51% property investment and 49% commodities," he said. "It meets the robust requirements of the Middle Eastern market and addresses issues of tradeability in secondary markets; it is both *Shariah* and AAOIFI-compliant."

AAOIFI, the Accounting and Auditing Organisation for Islamic Financial Institutions, is a self-regulatory body that sets and issues standards pertaining to accounting, auditing, governance, ethics and *Shariah* standards for Islamic financial institutions. The Malaysian bond certainly attracted interest; it registered a subscription rate of 2.7 times. More than one-third, or 43% of investors were offshore, with almost 33% Middle East participation. "This is a positive development in Malaysia's *sukuk* industry, and augurs well for future issuances," Choy said. "It shows that diversity is not a hindrance, and that the gap between *Shariah* compliance and conventional bonds can be bridged."

Positive

It registered a subscription rate of 2.7 times. More than one-third, or 43% of investors were offshore, with almost 33% Middle East participation.

MARKET BREAKTHROUGH

Al-Rajhi's involvement, besides being a first, indicates a widening interest in *Shariah*-compliant financial instruments being developed in the Asia-Pacific region. Even though commercial relations have always been cordial between Malaysia and the Gulf Cooperation Council (GCC) countries, interest in the Malaysian financial market has always been lukewarm at best. Funds from the Gulf region are still concentrated primarily on the US and European markets, with some investments flowing to Brazil, Russia, India, China and Japan.

This may be due as much to market proximity (in the case of Europe, India and China), as the lack of knowledge of Asia-Pacific offerings. It could also be due, to a certain extent, to the difference in interpretation of the related *Shariah* laws as followed in the respective countries. Middle Eastern *Shariah* scholars may consider Malaysian interpretations too liberal, and balk at investing in funds which they deem not compliant enough.

As such, Al-Rajhi Bank's involvement in *Sukuk ALIm*'s issuance - and as *Shariah* adviser together with Amanie Business Solutions Sdn Bhd - has considerably brightened up prospects in this area. It doesn't hurt, of course, that *Sukuk ALIm* is AAA-rated, and that Cagamas itself is highly regarded by the World Bank because of its success in the secondary mortgage market. Cagamas is second only to the Malaysian government where issuing bonds is concerned, and is one of the world's top *sukuk* issuers.

COLLABORATION ON MANY FRONTS

Lauding *Sukuk ALIm*'s success, Mashitah Osman, Director/Head, Corporate Investment Banking, Bank Islam Malaysia Berhad, described it as the result of hard work by many parties. "Innovation in *sukuk* is critical," she said. "When *sukuk* started in the early 1990s, the government pushed investment banks to come up with private debt securities, but when you offer *sukuk*, investors must accept the products – and the structures of the debt have to be simple and easily understood. Therefore, an element of education had to be introduced to create awareness and acceptance. Many GLCs undertook the issuance of *sukuk*, but at that point, it could be considered more or less "Stone Age" level!"

We have to bear in mind that *sukuk* have to be commercially viable, risk-wise, give good returns and be always transparent and on par with commercial bonds.

Fortunately, the government was supportive and it wasn't long before more varieties of *sukuk* were introduced from 2001. These catered to the demands of the investors who were quickly becoming more discerning. "Master plans came into the picture too," she continued. "Proper guidelines were drawn up and *sukuk* started to gain prominence among government-owned entities locally and abroad. Today, our primary challenge is to come up with *Shariah*-compliant *sukuk* that is of world standard."

Acknowledging that it was the larger corporations that pushed for changes in parameters, she said that *sukuk* structures gradually expanded and became more flexible to accommodate the financial objectives of a wider range of clients. Still, there has not been as much interest in *Shariah*-compliant bonds as could be expected, given the quantum of effort that has gone into preparing the ground for this particular financial instrument. "It's not just about being *Shariah*-compliant," Mashitah admitted. "There will always be comparisons between *sukuk* and conventional bonds. Investors expect the same returns from *sukuk* as they would derive from conventional bonds, so we have to be able to match the risk and reward models of both types."

INPUT

To be able to achieve this, players need to have adequate knowledge of Islam as a way of life. This is needed to bring *sukuk* to a meaningful level. It can be attained with the input of scholars, but there are still challenges ahead that can only be met by being constantly innovative.

To be able to achieve this, players need to have adequate knowledge of Islam as a way of life. This is needed to bring *sukuk* to a meaningful level. It can be attained with the input of scholars, but there are still challenges ahead that can only be met by being constantly innovative. We have to bear in mind that *sukuk* have to be commercially viable, risk-wise, give good returns and be always transparent and on par with commercial bonds.

IMPROVING ON EXISTING STRUCTURES

The search for the perfect *sukuk*, or the race to develop the most viable one, can be overwhelming, which may prove a major deterrent for many bodies considering the possibility of entering the field. Agreeing with Mashitah that comparisons are inevitable, Choy remarked that there was nevertheless no reason to reinvent the wheel, saying, "If elements already exist out there which can be converted without too much manipulation, there is no need to start from scratch. The important thing is to be proactive and continuously search for ways to improve what you have – or you will not start anything at all."

While *Shariah*-based activities (and *Shariah*-compliant financial instruments) must benefit the *ummah* or Islamic nation, the activities and structures themselves are very challenging to formulate and apply, but, as Mashitah pointed out, "There are already some elements present in current structures that can be built on, so perhaps there should not be so much preoccupation with being *Shariah*-based or *Shariah*-compliant. If there is no compromise of the returns, it's okay."

Would having rating standards for *sukuk* make them more attractive? "The rating analyses the viability of the bond by assessing the ability of the originator to pay back the amount borrowed," said Haneef. "So the cash flow of the project has to be robust enough. But one of the main challenges is actually the stigma attached to *sukuk* originating in this part of the world. Sometimes it seems that Malaysia is in one valley, and the rest of the world is in another! People are still sceptical of products that originate from here. There is a perception in banking of "Middle-East *sukuk*" or "Hong Kong *sukuk*" – not just "*Shariah*-compliant *sukuk*," which is what it should be. But this can be overcome with transparency, better education and overall awareness. The bottom line is, it really doesn't matter where, how or why it is issued, or who issues it – it should be acceptable as long as it is compliant." ✱

■ Majella Gomes is a senior freelance journalist based in Kuala Lumpur.

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