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DECEMBER 2013

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ASEAN BANKS
ON CROSS-BORDER OPPORTUNITIES

SIMPLIFYING CUSTOMER AND BANKING EXPERIENCE

HOW TO SUCCEED IN CORPORATE BANKING

UNIFIED AGAINST CRIME

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SECRETS TO REGIONAL SUCCESS

THE YEAR 2015 is set to usher in a whole new era of integration and liberalisation for the ASEAN (Association of Southeast Asian Nations) region as the ASEAN Economic Community (AEC) officially clocks in. While 2015 is a notable milestone, regionalisation and liberalisation will continue to be an arduous work in progress as ASEAN strives to overcome teething problems and learn from the precedents of European Union (EU) integration.

Among the goals of AEC are the integration of ten highly disparate markets into a colossal single market of over 600 million people and the dismantling of trade and economic cross-border barriers, resulting in tremendous opportunities for economic and business growth.

In particular, the financial services sector stands to benefit immensely from ASEAN's unfolding markets as barriers tumble down. But while prospects are bright, risks abound too, as we report in our cover story on 'ASEAN Banks' on Cross-border Opportunities'. In short, well-capitalised local banking giants based in the more developed markets of Singapore and Malaysia – such as OCBC, DBS, Maybank and CIMB – could spread their wings regionally, unencumbered by rivals from the developed EU and US markets as the latter retreat to lick their wounds from the numerous banking crises and scandals post-2007. There is also ample opportunity to develop *Shariah* banking models in the ASEAN blue ocean for Islamic finance.

Bear in mind though that there is no one-size-fits-all formula for success. The ultimate winners will be those banks and financial institutions which are open to change and tailor their strategies to fit the quirks of individual markets and segments. Innovation and reinvention will be the core ingredients for regional success.

Regulatory efforts to strengthen banks and manage risks are critical to support regionalisation efforts. Bank Negara Malaysia (BNM) - headed by Governor Tan Sri Dr. Zeti Akhtar Aziz (ranked by Global Finance magazine as one of three Grade A central bankers for 2013) - has introduced new legislation effective 30 June 2013. The Financial Services Act 2013 (FSA) and the Islamic Financial Services Act 2013 (IFSA) are carefully planned to develop the conventional and Islamic financial sectors, enhance financial stability and regulatory oversight, and ensure good governance. These are essential to place Malaysia and its financial institutions on a stronger footing in a more competitive and integrated landscape. In this issue, we assess the most salient and impactful regulations in the FSA and IFSA.

Another factor that drives success is people. The Malaysian, ASEAN and Asian banking sectors currently suffer numerous talent challenges. How do we get people of the right calibre and competencies to fill the evolving banking roles of the 21st century? How do we develop a sustainable talent pipeline? The upcoming Asian Banking School proposes a solution which will fuse innovative pedagogies and technology with professional standards and blended learning cultures and systems to develop the needed talent. To be officially launched in December 2013, the School aims to help banks rethink their education and training agenda to compete and succeed in a borderless market, says IBBM CEO Tay Kay Luan.

Last but not least, banks should pay attention to mitigating the risks of money laundering and terrorism financing which are heightened with liberalisation and borderless markets. Dr. R. Bhaskaran, Chief Executive Officer of the Indian Institute of Banking and Finance, advises banks to emphasise customer due diligence and comply with Know Your Customer (KYC) norms in order to meet the increasingly stringent challenges of AML (anti-money laundering) and CFT (combating the financing of terrorism). Collaboration between banks and regulators is also vital to ingrain AML/CFT principles and ensure the AML/CFT regime is implemented and enforced effectively.

While it is hardly exhaustive, we hope that this issue of 'Banking Insight' offers ample food for thought as you and your organisation navigate the thrilling yet challenging waters of the upcoming ASEAN regionalisation. Do write in to us with bouquets or brickbats at ***oili@ibbm.org.my.*** We welcome your feedback! ✱

Hope you have a fruitful read.

THE EDITOR

We want to hear what you have to say on *Banking Insight.*

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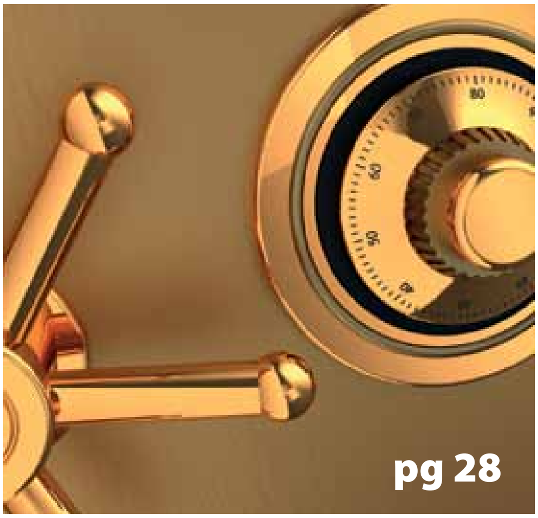

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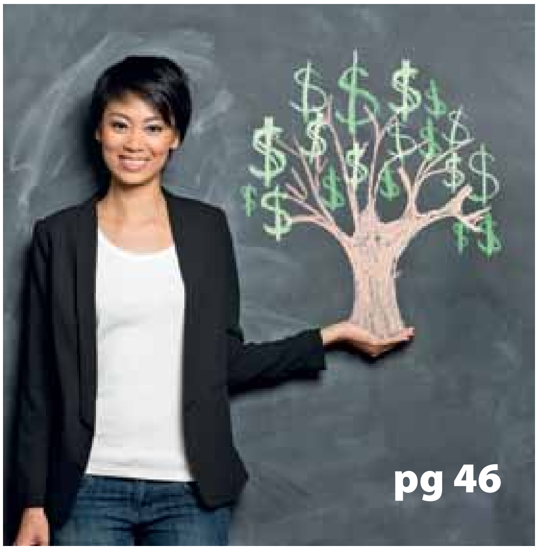

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Forecast

ADB revised down its 2013 gross domestic product (GDP) growth forecast for the region to 6% from 6.6% seen in April.

ASIAN GROWTH SOFTENING

SOFTER THAN EXPECTED economic activity in China and India and jitters over the US quantitative easing (QE) programme will weigh on Asia and the Pacific's growth prospects in the near term, noted a recent Asian Development Bank (ADB) report.

"Asia and the Pacific 2013 growth will come in below earlier projections due to more moderate activity in the region's two largest economies and effects of QE nervousness," said ADB Chief Economist Changyong Rhee. "While economic activity will edge back up in 2014, current conditions highlight the need for the region to exercise vigilance to safeguard financial stability in the short term while accelerating structural reforms to sustain economic growth in the longer term."

In an update of its flagship annual economic publication, 'Asian Development Outlook 2013', the ADB revised down its 2013 gross domestic product (GDP) growth forecast for the region to 6% from 6.6% seen in April. For 2014, growth is now projected at 6.2% from 6.7% in April. In 2012, growth came in at 6.1%.

The ADB said that Southeast Asia's growth will be crimped by the soft performances of its three biggest economies with lacklustre exports and moderating investment weighing on Indonesia, Thailand and Malaysia. By contrast, the Philippines is expected to continue to perform strongly. The sub-region will grow 4.9% in 2013, with the pace set to quicken to 5.3% in 2014, as it benefits from an investment recovery and firmer exports, supported by improved global trade and recent currency depreciations. ✱

World Bank sets interim poverty target at 9% in 2020

WORLD BANK GROUP President Jim Yong Kim has called for urgency in tackling poverty and in October 2013 announced that the World Bank has set an interim target to reduce global poverty to 9% in 2020. If achieved, this would mark the first time the rate has fallen into the single digits.

The milestone was based on a World Bank economic analysis of global poverty trends towards reaching a goal of ending extreme poverty by 2030. Living in extreme poverty is defined as below USD1.25 a day.

World Bank Group economists found if developing countries continued their strong growth rates in the coming seven years – far from a given – the global rate would dip below 10% for the first time since such figures were first reported in the World Development Report in 1990. Since 1990, when 43% of the people living in developing countries lived in poverty, global poverty has been in a steady retreat. An estimated 1.9 billion people lived in poverty in 1990, and that number fell to 1.2 billion in 2010.

Reaching 9% in 2020 would mean an estimated 690 million people would still be living in extreme poverty. If achieved, the world would have 510 million fewer people living in poverty in 2020, compared to a decade earlier. That would be the equivalent of half of the population of the continent of Africa, or more than double the population of Indonesia. ✱

GOVERNANCE KEY TO ASIA-PACIFIC

ASIA AND THE PACIFIC'S ECONOMIC GAINS must be matched by stepped-up efforts on governance so that growth benefits can be more evenly shared and development progress locked in, according to the 'Asian Development Outlook 2013.'

"Progress on good governance has lagged well behind the region's economic achievements and there has been little headway in closing the governance gap with advanced economies," said ADB Chief Economist Changyong Rhee. "There is abundant global evidence to show that governance improvements correlate strongly with faster and more inclusive growth, higher investment, and more rapid poverty reduction."

> ***Political stability and regulatory quality are the key issues in South Asia.***

On a sub-regional basis, Central Asia is weak on all governance indicators while East Asia shows strong government effectiveness, regulatory quality and rule of law, but lags in controlling corruption. Southeast Asia also struggles with controlling corruption and giving a voice to all its citizens. Political stability and regulatory quality are the key issues in South Asia.

Since individual countries are at different stages of development, there is no one-size-fits-all approach to governance improvements, the report says. However as a general rule of thumb, low-income countries should look to improve government effectiveness, the quality of regulation and rule of law, and to scale up corruption controls to support growth. Middle-income countries, meanwhile, need to respond to the aspirations of increasingly affluent citizens who want to have a greater say in the development process. ✱

REMITTANCES BOOM

REMITTANCES CONTINUE to be a major source of income for the developing world, which is expected to receive USD414bn in migrant remittances in 2013, an increase of 6.3% over the previous year. This is projected to rise to USD540bn by 2016.

Globally, the world's 232 million international migrants are expected to remit earnings worth USD550bn this year, and over USD700bn by 2016, according to the latest issue of the World Bank's Migration and Development Brief.

The top recipients of officially recorded remittances for 2013 are India (with an estimated USD71bn), China (USD60bn), the Philippines (USD26bn), Mexico (USD22bn), Nigeria (USD21bn), and Egypt (USD20bn). Other large recipients include Bangladesh, Pakistan, Ukraine and Vietnam.

Growth of remittances has been robust in all regions of the world, except for Latin America and the Caribbean, where growth decelerated due to economic weakness in the United States.

However, the high cost of remittances is a burden. The World Bank highlighted that the high cost of sending money through official channels continues to be an obstacle to the utilisation of remittances for development purposes, as people seek out informal channels as their preferred means for sending money home. The global average cost for sending remittances is 9%, broadly unchanged from 2012.

While remittance costs seem to have stabilised, banks in many countries have begun imposing additional 'lifting' fees on incoming transfers, including remittances. Such fees can be as high as 5% of the transaction value. Some international banks are also closing down the accounts of money transfer operators because of money laundering and terrorism financing concerns. ✱

ASEAN Banks *on* cross-border opportunities

As the Association of Southeast Asian Nations (ASEAN) heads towards integration, a window of opportunity is opening for banks here to become a major force. Challenges remain as the ASEAN countries are different in economic status and outlook, but the rewards could be significant for the banks that get the regionalisation formula right.

JESSICA FURSETH

Asian banks are facing a convergence of opportunity, one where the future could see the local players and not the beleaguered internationals emerging as winners in the regionalisation battle. Western banks have long looked to the booming Asian markets to boost sluggish growth in their home countries, but concern over the future of the Euro has put pressure on funding and distracted European banks from their foreign expansion plans. Consequently, according to data from Morgan Stanley, European banks have seen their share of large Asian trade deals slumping to just 8% from the 2010 level of 43%.

While Western banks are still struggling with the aftermath of the recession, Asian banks have largely been spared, and they are stepping up to take advantage of this situation. Asian cross-border banking merger and acquisition (M&A) deals from 2006-2010 had more than doubled from the five years prior, according to the Oliver Wyman consultancy's 'Future of Asian Banking' report, and the trend has persisted. In further evidence of strength, Asian banks have seen an average revenue growth rate of 9%; Singapore has become a global hub for wealth management; while return on investment in developed markets such as Malaysia is now over 15%.

PRODUCTS

IN FURTHER EVIDENCE OF STRENGTH, Asian banks have seen an average revenue growth rate of 9%; Singapore has become a global hub for wealth management; while return on investment in developed markets such as Malaysia is now over 15%.

"Not only are Asian banks increasingly important components in investors' portfolios, increasing the competition for capital that Western banks face, but they now have their own stock currency to finance acquisitions: a new-found financial strength that they have started to deploy overseas," said Jason Ekberg, Principal at Oliver Wyman.

Singapore's DBS Bank and Malaysia's CIMB and Maybank are among the financial players stepping up where European banks are retreating, often using their agility to compensate for comparatively less sturdy balance sheets. Last year, CIMB acquired part of the Asian businesses of the Royal Bank of Scotland, to name one example. Meanwhile, DBS pledged to stick to its plans to expand in Indonesia even though its plans to buy Bank Danamon recently stumbled at a regulatory hurdle.

ASEAN banks: Leaders and followers

"The centre of economic gravity is shifting to East Asia, and ASEAN is an important market within that," said Iwan Azis, Head of the Office of Regional Economic Integration at the Asian Development Bank. Azis told the 'Wall Street Journal': "Asian integration is happening even without deliberate policies or initiatives. It's market-driven."

Established in 1967, the Association of Southeast Asian Nations (ASEAN) is made up of ten countries: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam. Over 600 million people live in the region, or around 9% of the world's total. The group's combined gross domestic product (GDP) stood at USD2.3 trillion in 2012, or 3% of the world's total, according to data collected by Deutsche Bank. Income levels among ASEAN member countries are however hugely diverse: GDP per capita in Singapore stands at around USD49,000 at the one end, while Myanmar and Cambodia have a GDP per capita of just below USD900.

The three biggest banks in ASEAN ranked by Tier-1 capital and profitability are all found in Singapore. DBS Bank tops the rankings among ASEAN banks, making it the 58th largest lender in the world. Other leading Singapore banks are Overseas Chinese Banking Corporation (OCBC) and United Overseas Bank. Singapore-based banks account for 28% of all assets in the ASEAN region, but aggregated pre-tax profits only account for 19% of the total profits in the region.

"The centre of economic gravity is shifting to East Asia, and ASEAN is an important market within that."

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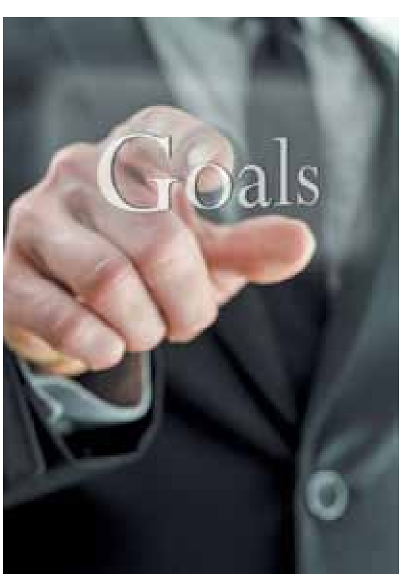
A more even balance between assets and profits is found in Malaysia, whose banks account for 28% of the total assets in ASEAN and 27% of profits. Looking at just Tier-1 capital, Singapore's lead on its neighbours is shrinking: Malaysia's Maybank and Thailand's Bangkok Bank are gaining on the leaders. Public Bank, CIMB Group, Siam Commercial Bank and Kasikornbank also feature among the top ten ASEAN banks.

The 43rd ASEAN Banking Council meeting takes place this November in Myanmar, a country whose underdeveloped financial sector stands in stark contrast to the leading ASEAN nations. In the past year, Myanmar has taken a number of steps to overhaul its banking system, including floating the currency and implementing a foreign investment law. At last year's Banking Council meeting in Kuala Lumpur, participants were urged to focus on areas of mutual collaboration in order to stand up to the challenges and risks in the region. In her keynote speech, Bank Negara Malaysia Governor Tan Sri Dr. Zeti Akhtar Aziz pointed out how much diversity remains between the economies within ASEAN. This means efforts should be focused on increased financial integration, higher levels of intra-regional trade, and greater two-way cross-border investment flows.

National and international growth

As ASEAN banks enjoy the convergence of growing local markets and a partial retreat of international players, regionalisation remains a hot topic. "Everybody is trying to increase economic scale, and focusing in the Asian region. We see the Asian banks trying to increase their economic scale, not just in their respective home markets but regionally," Winang Budoyo, Chief Economist at CIMB Niaga, said at the Sydney 'Bellwether' Summit arranged by 'The Economist'. Anton Gunawan, Chief Economist at Bank Danamon Indonesia, identified three 'pull factors' encouraging ASEAN banks to look outside their home markets: the growing influence of under-penetrated markets for financial products and services; the need to finance infrastructure projects; and the attraction of high yields in mining-related business activities.



Having said that, banks looking to expand beyond their national borders should not underestimate cultural factors, both those within their own company as well as in the country of destination. At the 'Bellwether' Summit, Graham Hodges, Deputy Chief Executive Officer of the Australia and New Zealand Banking Group, said: "As you enter new markets, you really have to state your sense of permanency to the new markets. That's part of the value of setting up a retail franchise in a market. Go into Hong Kong, Vietnam or Singapore and you need to show people you are committed to the market for the long term. That requires you to have (a) full service bank franchise, even if you're picking the niches and trying to find selective ways of building your brand within that market."

Regulatory support is also vital to expansion. For instance Bank Negara Malaysia's Financial Sector Blueprint for the decade to 2020 highlights greater regional and international participation as key themes for the country's financial institutions. "The central bank appears to be encouraging Malaysian financial institutions to go beyond the Malaysian market, to have a broader base of clients and assets, and not just lending to Malaysian clients," Munir Abdul Aziz, Partner at law firm Wong & Partners in Kuala Lumpur, told 'Thomson Reuters'. Smaller banks also look likely to follow in the footsteps of CIMB and Maybank to become more integrated in the regional economy.

ASEAN Juniors

While Singapore and Malaysia are in the lead among the ASEAN banking peer group, other countries are starting to close the gap. "There is a window of opportunity over the next few years to make Bangkok a financial services centre in Asia, through the right regulatory regime, the right government response, and the right response from the Thai banks," said Richard Lumb, Group Chief Executive for Financial Services at Accenture. Speaking at a Bangkok news conference earlier this year, Lumb noted that Thai commercial banks, which so far have focused mostly on their home market, would have to move away from their strategy of being takeover targets for banks from Singapore and Malaysia. Instead, they should look for opportunities to take over other banks in the region themselves.

In Vietnam, bank lending has expanded by 33% per year over the

> "**As you enter new markets,** you really have to state your sense of permanency to the new markets."
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> **Graham Hodges,** Deputy Chief Executive Officer of the Australia and New Zealand Banking Group,

past decade, the strongest growth rate recorded by any ASEAN country. "While the reported level of Vietnam's non-performing loans appears to be under control, their true volume is likely to be much higher than reported figures," said Richard Dobbs, Director at McKinsey Global Institute in Seoul, following the research report 'Sustaining Vietnam's Growth'. The Vietnamese government has launched a number of measures to combat this potential problem, including a 20% cap on credit growth and limits on loans to non-productive activities. "Yet these measures are unlikely to suffice, notably because new caps on interest rates, which are significantly below underlying inflation, are likely to counteract the intention of policy and spur more demand for loans," said Dobbs. While Vietnam's growth has caught the attention of foreign investors, the country lags behind many of its Asian peers in competitiveness. The government's efforts to remedy this include simplification of start-up processes, improving permitting processes, and reducing tax rates. Still, a key problem remains that Vietnam has a large share of state banks, some of which may lend on grounds of politics rather than finance. Plus, cross-holdings are prevalent and weaken corporate governance.

While a less developed banking system means countries like Vietnam have a bigger job ahead when it comes to getting it right on regionalisation, a somewhat blank slate may also be a potential advantage. This may be the case for Myanmar, according to McKinsey Global Institute's research report 'Myanmar's Moment'. The risks are high, but international goodwill is significant after decades of authoritarianism as the government has been pushing forward with numerous economic reforms. The currency has been floated, the central bank has been made largely independent, fiscal policy has been decentralised, and tax reform has been introduced. "With little legacy infrastructure in place, Myanmar can use digital technology to avoid some of the cost of a more conventional brick-and-mortar approach to such sectors as banking, retail, education, healthcare, and agriculture," said Dobbs. Foreign banks will be allowed to operate in Myanmar after the integration of ASEAN in 2015. However, by April 2013, 17 foreign banks already established offices in the country in anticipation of the change. In other words, the moment to get in on the ground in Myanmar is now.

"With little legacy infrastructure in place, Myanmar can use digital technology to avoid some of the cost of a more conventional brick-and-mortar approach to such sectors as banking, retail, education, healthcare, and agriculture."

Richard Dobbs, Director at McKinsey Global Institute

Opportunity and challenge

While ASEAN's banks as well as its governments demonstrate a desire and intent to push forward with regionalisation, the opportunity is not without its challenges. One of these is the complexity of local markets, as ASEAN countries remain significantly different from each other in terms of customer behaviour and product preferences, regulations, the role of the public sector, and the type of competition prevalent in each area. "This need for local customisation of banking business models makes it harder to generate cross-border synergies than in industries that are less regulated, or ones where product and service needs are largely uniform across markets," said Oliver Wyman's Ekberg. "This is exacerbated by the importance of trusted brands in the banking industry, particularly when one considers that the local brands have had many years to establish their reputation in the market."

Ekberg pointed out how international banks with significant presence in Asia, such as Citibank, HSBC and Standard Chartered, spent decades finding their feet in terms of presence, culture, management, brand and client relationships. By that logic, banks from less-developed banking markets may face a battle that is possibly even harder. "On the other hand," countered Ekberg, "the top-performing internationally-active Asian banks perform as well or better than their domestic counterparts, suggesting that while these challenges are great, the opportunities are also significant and attainable for those banks that get both the strategy and execution right."

More than a decade later, the 1997-1998 Asian financial crisis is now starting to be sufficiently far away in memory for the ASEAN region to reclaim its place along global growth markets such as Brazil, Russia, India and China (BRICs) and Mexico, Indonesia, Korea and Turkey (MIKTs). According to the World Bank's 'Ease of Doing Business' index, Singapore and Thailand rank on par with advanced countries, while Vietnam and Indonesia are at similar levels to the BRICs. Malaysia particularly has gone to notable lengths to provide incentives for foreign investors to facilitate job creation and establish industries.

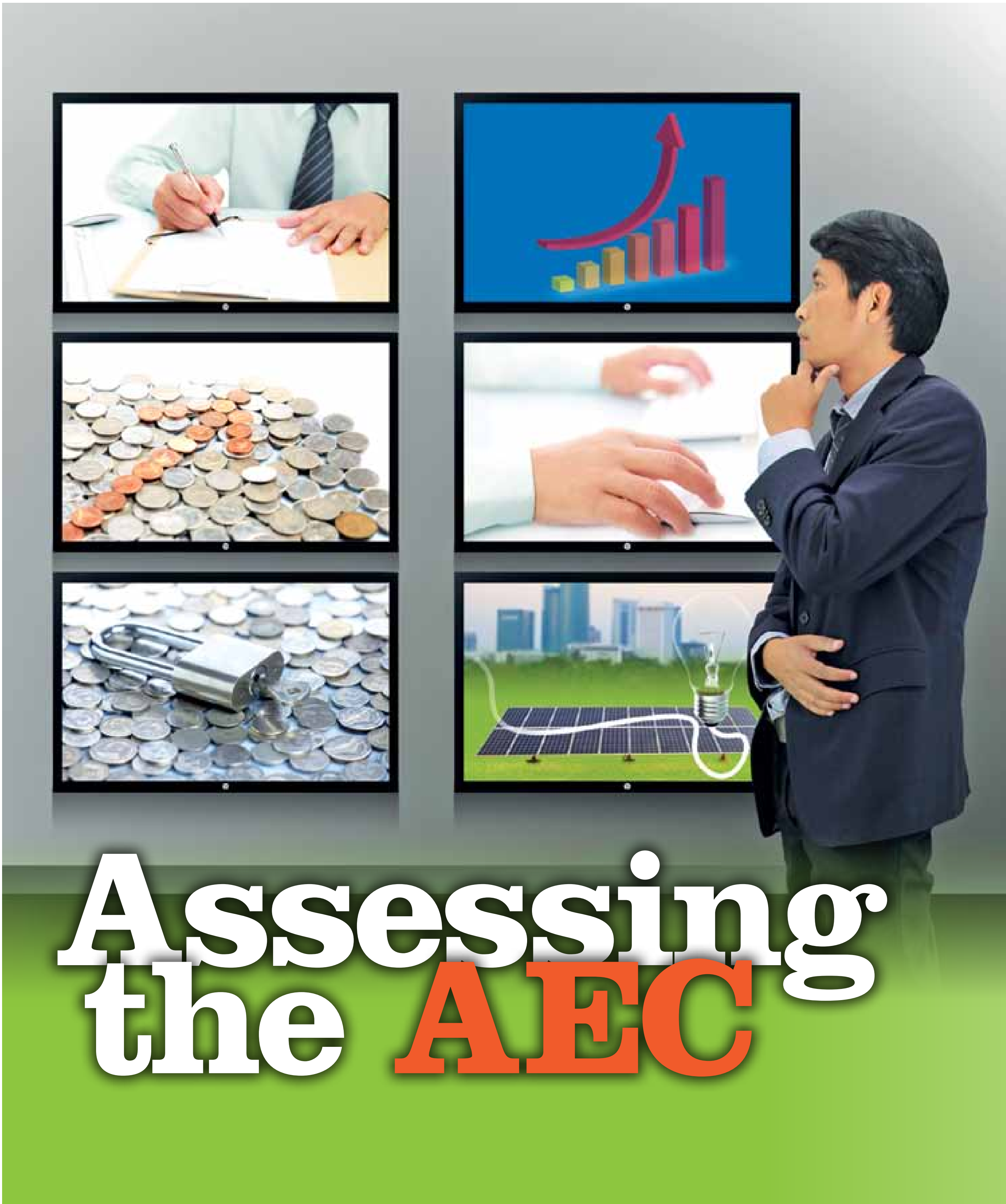
"The first-mover member states, including Indonesia and Thailand, have the potential to become the next BRICs, and their vast domestic demand market should be targeted," Kim Kyung-Hoon, Research Associate at the Samsung Economic Research Institute (SERI), wrote in the 'SERI Quarterly'. Drilling down, Islamic finance and Generation Y are sub-segments with high potential. "By promptly responding to the consumption trends of younger generations and Muslims, new markets should be explored while expanding advancement into industrial and social infrastructure, which are expected to see fast growth."

"The first-mover member states, including Indonesia and Thailand, have the potential to become the next BRICs, and their vast domestic demand market should be targeted."

Kim Kyung-Hoon, Research Associate at the Samsung Economic Research Institute (SERI)

Alliances between players would significantly aid ASEAN's banks as they capitalise on this growth, as the region currently has a vast number of small banks which may be ripe for consolidation. "Bigger banks in the sector will become better capitalised and more consolidated," Fauzi Ichsan, Senior Economist at Standard Chartered Bank in Jakarta, Indonesia told the 'Wall Street Journal'. "The consumer will be happier with a more solid banking system, as it would provide them with cheaper financing." ✱

■ Jessica Furseth is a freelance journalist based in London.



Assessing the AEC

> In 2007, the leaders of ASEAN affirmed their commitment to creating the AEC, in an effort "to transform ASEAN into a region with free movement of goods, services, investment, skilled labour, and freer flow of capital."

THE ASEAN ECONOMIC COMMUNITY IS AN AMAZING OPPORTUNITY FOR SOUTHEAST ASIAN NATIONS TO POOL THEIR RESOURCES AND POTENTIALLY BECOME A GLOBAL POWER BLOC. BUT CREATING THE **AEC** IS A MAMMOTH CHALLENGE, ONE WHICH WILL CONTINUE LONG AFTER THE 2015 DEADLINE. ULTIMATELY, THE KEY TO THE SUCCESS OF THE **AEC** IS FULL AND COMPLETE CAPITAL ACCOUNT AND FINANCIAL SERVICES LIBERALISATION, WITH EVENTUAL ELIMINATION OF ALL RESTRICTIONS ON CROSS-BORDER CAPITAL FLOWS AND FINANCIAL SERVICES.

ANNA PERRY

The ASEAN Economic Community (AEC) is a potential game changer for its members, the ten countries making up the Association of Southeast Asian Nations (ASEAN). In 2007, the leaders of ASEAN affirmed their commitment to creating the AEC, in an effort "to transform ASEAN into a region with free movement of goods, services, investment, skilled labour, and freer flow of capital." It is a mammoth task and the deadline at the end of 2015 is approaching fast. Understandably, critical voices are arguing the goal looks unrealistic in the time allotted, at least for the less-developed ASEAN economies.

Recent events since 2007, particularly the global financial crisis of that year and the subsequent recession – have somewhat affected ASEAN development. Banks local to the Eurozone have struggled to maintain their Asian expansion programmes, leaving room for ASEAN players to step up their regionalisation efforts. For the AEC, the struggles in the European Union (EU) may provide a valuable case study for its own union, which also attempts to tie together a group of similar but different nations.

"There is a fundamental rethinking of banking by the international community in the aftermath of the recent global crisis. These are both driving and shaping the raft of reforms at the global level," said Tan Sri Dr. Zeti Akhtar Aziz, the Governor of Bank Negara Malaysia, in her keynote speech at last year's ASEAN Banking Council. In light of how the EU has initiated changes following the crisis, she described four elements necessary for developing a more sustainable banking sector in the ASEAN region: reduced complexity and increased transparency in the banking sector; stronger focus on more responsible and sustainable financial business practices; sound governance of financial institutions; and reinforcing buffers to withstand future shocks.

"This is a timely juncture for the industry to reflect and take charge of the efforts to rebuild and strengthen the foundations for more sustainable finance," she concluded. "Financial institutions with a regional footprint in ASEAN have the potential to contribute to the development of the financial systems in countries where they operate. There will be tremendous payoffs to be reaped from pursuing such sustainable strategies."

Capitalising on diversity

The diversity between the ten ASEAN countries could lead to positive synergies for the AEC, with advanced economies such as Singapore providing capital and knowledge while less-developed countries such as Myanmar contribute competitive costs. Companies with already developed regional networks do however stand to benefit the most, as the union will ease the movement of capital, goods and labour. Similarly, a surge in trade and investment will be a boon for the banking sector. A potential negative may be intensified competition or salary constraints for low-skilled workers, while smaller countries may run the risk of inflation surges due to sudden surges in capital inflows.

There will undoubtedly be winners and losers among members of the AEC, which will remain a work in progress long after the 2015 kick-off. Different countries will experience various effects, but the European example suggests the overall impact of the AEC should be positive; the formation of the EU Single Market led to the gradual increase in its share of global foreign direct investment (FDI) inflows, to 41% in 1993-2007 up from 34% in 1980-1992, according to data from Deutsche Bank. Back in 2003, McKinsey estimated that an integrated ASEAN would increase regional gross domestic product (GDP) by at least 10%, or nominally USD50bn, while reducing the operational costs by up to 20%. According to the International Monetary Fund (IMF), ASEAN should see 5.5% in annual growth until 2015, raising the average per capita income to USD10,603.

In an effort to monitor members' readiness as they work towards the union, ASEAN publishes the AEC Scorecard; the overall score stands at 77.5 out of 100 as of April 2013. Most progress has taken place in the area of global economic integration, with work still remaining on creating a single market and production base, establishing a competitive economic region, and securing equitable economic development. "The score appears to suggest that challenges with regard to non-trade barriers remain considerable, and have yet to be tackled to create a smooth-functioning single market and production base," said Syetarn Hansakul, Senior Economist at Deutsche Bank.

"It is now less than three years before the expected AEC launch at the end of 2015. A lot of work remains to be done to achieve a credible and meaningful start," said Hansakul, pointing to issues around non-tariff measures, streamlining systems around customs and logistics, and development of the small business sector. "Thus far, the public impression of AEC is that it is driven by the government sector, which needs to be corrected," said Hansakul. "AEC's success depends crucially on private sector involvement and public support. Greater efforts should be made to raise awareness of AEC among the business community to bring it on board."

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Country differences

Progress towards the AEC has come the furthest for the core members of ASEAN, namely Thailand, Malaysia, Singapore, Indonesia and the Philippines. Efforts have been made to ease trading between these countries, but significant gaps remain between them and the lesser developed countries, which remain sensitive in both political and economic terms. Having said that, the core members continue to maintain certain restrictions on trade and foreign investment in order to protect local industry.

"Among the things we want to do is to remove import duties between ASEAN countries. Whereas some countries like Singapore, even Malaysia, do not depend on import duties for revenue, the other countries still depend on this," Tun Dr. Mahathir Mohamad, former Prime Minister of Malaysia, said in an interview with 'The Nation' in September. Asked how poorer countries in the union will manage, Mahathir pointed to how the AEC should consider the lessons of the EU, where a common currency for domestic use and not just for trading created problems when the value of goods and services was not the same in every country. "Before we come together in a single community, we must understand what happened to Europe and avoid the mistakes they made. We have to understand the reality and position of the countries when we come together: which one is poor, which one is rich, what is the cause of poverty," said Mahathir, suggesting allowances should be made for Myanmar, Laos and Cambodia for them, to an extent, to protect their economies.

While the lesser developed AEC nations may look the most vulnerable ahead of integration, nervousness can be found among also the core nations. "Discussions inevitably boil down to one point: the need to strengthen the Philippines domestic economy before the floodgates of trade are thrown open," said Junie del Mundo, Chair of the ASEAN Integration Committee in the Management Association of the Philippines. Writing in 'Inquirer Business', Mundo said: "At the minimum, policy changes at the macroeconomic and microeconomic levels will be necessary to strengthen industries and companies ahead of the AEC. Each firm would need to identify its strengths and comparative advantages in order to stay ahead of the competition in this new and immensely more challenging environment."

Anwar Nasution, Professor at the University of Indonesia and former Senior Deputy Governor of Bank Indonesia, was even more frank in his concerns: "The Indonesian banking system needs to be reformed to survive in the coming ASEAN community in 2015. Reforms must improve market competition to lower interest rates, improve banking services and increase the competitiveness of domestic banks both domestically and internationally." Writing in 'Jakarta Post', Nasution issued a call for a deeper money market and more competitive banks as necessary to make the present monetary policy work: "Foreign banks are still needed to supplement the poor capability of domestic banks and to raise long-term foreign currency funds in the international market to finance risky or long-term projects such as mining."

Lessons from the EU

With the European crisis continuing to affect EU sovereign debts and banking markets, ASEAN leaders are paying close attention to how this could provide a valuable lesson for the AEC. While other regional integration projects have been attempted, such as the African Union, Gulf Cooperation Council, and Mercosur in South America, the EU is a vastly more successful example of a long-term collaboration where discussions have resulted in real change.

The beginnings of what later became the EU first started back in 1957, meaning the region has had a long time to develop the current system. In comparison, the AEC's roots reach back only to 2003. EU leaders have spent significant time and resources to try and harmonise conditions between the member countries. Despite this, the wealthier states were called upon to financially bail out the weaker in the recent crisis; Greece, Portugal, Ireland and Cyprus still remain dependent on rescue loans from the EU and the IMF.

While the vast differences in the financial status of the ASEAN countries could suggest a similar risk in the event of a future crisis, Asia's push for greater integration still makes sense, said Iwan Azis, Head of the Office of Regional Economic Integration at the Asian Development Bank. "The differences between ASEAN and the EU are stark. Integration in ASEAN and in Asia has been market-driven, outward-oriented, and institution-light. Conversely, the European project was conceived and driven by politicians, and is internally oriented and institution-heavy. Asia consists of a highly disparate set of economies in terms of size, natural resources, human capital, and governance. Against this backdrop, its remarkable progress in building consensus on enhanced cooperation during the past two decades has occurred because nations have been realistic about what is achievable."

Regional financial integration has accelerated across Asia since the 2008 financial crisis, and intra-regional and South-South trade is growing faster than trade with Europe and the US. But, noted Azis, integration is not the same as cooperation, which will be necessary for the AEC to withstand future crises: "The belief that Asia has unlimited resilience is bravado and *naiveté*. We must use Asia's resilience to prepare the safety nets to protect against future shocks. As Asian integration strengthens, we must, unlike Europe, allow markets to drive the process, with the region's governments and institutions cooperating to smoothen the process and manage potential future contagion in a region where economic and financial ties are growing."

Overall, the Eurozone crisis has done little to dissuade commentators that the AEC should go ahead, with the general consensus being that the two regions are fundamentally different. "The process or approach to integration in Asia has never been and will never be the same as in Europe," said Ramesh Subramaniam, Deputy Director-General of the Southeast Asia Regional Department of the Asian Development Bank. The differences across the region mean Asia has needed to evolve its own model to integration, one that is more bottom-up, market-led and institution-light in relation to Europe, said Subramaniam. He added: "In the aftermath of the global financial crisis, Asia's contribution in sustaining global economic growth has become far more critical."

Where Asia is similar to Europe is that the region has more arguments in favour of greater cooperation and integration than it has arguments that detract. Subramaniam pointed to how ASEAN's growth has been driven largely by trade: "Regional production networks have been the mainstay of trade in the region for more than two decades now. Since the onset of the global crisis in 2008, the shifting trade patterns have led to an increase in intra-regional trade, in final goods. All major economies in that sub-region are now looking to boost trade."

As the AEC is not considering establishing a common currency, the EU's handling of the Eurozone crisis may not be all that applicable to the AEC right now. Still, the progress of the monetary union will be closely studied, as it is not unlikely that the AEC may consider going down a comparative route in future. "There is much that can be learned from the EU and its responses to various crises, including that of spring 2010," said Fraser Cameron, Adjunct Professor at the Hertie School of Governance in Berlin and Senior Adviser at the European Policy Centre. The EU is however a unique organisation, and how its members deal with a crisis may not be relevant to less-advanced groupings, noted Cameron. In a paper for the Council on Foreign Relations, Cameron wrote: "If one were to take monetary union as an objective, then it would seem clear in hindsight that a more integrated political and economic structure would be necessary to monitor public debt and help prevent speculation. But no other grouping is anywhere close to a customs union or single market, let alone a common currency."

Integration is a difficult process for any grouping, resulting in setbacks and crises as the members grapple with their unique combination of circumstances. While the EU has had its fair share of critics, the group's record of recovering from crises and moving ahead is strong, largely due to firm political will. "The resounding lesson of the EU model is the necessity of genuine investment by member states in the goal of regional integration," said Cameron. "National governments would be wise to put the long-term goal of cooperation above more immediate domestic priorities. More importantly, if integration is to succeed, governments and publics should believe that it is in their vital national interest. Without such commitment, regional groupings will crumble at the first bump in the long road to integration."

For ASEAN members, much work remains before the AEC can take shape in 2015, and even beyond this date the union would need to continue developing and changing in decades to come. The commitment and intent of the leadership will remain vital to its success, as concluded by the Asian Development Bank in its 2013 study 'The road to ASEAN financial integration': "The process of integration and consolidation will continue to be an inescapable reality as long as member states wish to remain part of the global economy. As not to be left out, the ASEAN member states must commit anew to creating a single market and production base. Full and complete capital account and financial services liberalisation is ultimately key to the success of the AEC."

The report concluded by acknowledging the long-term commitment of the AEC project to its ambitious end-goal: "Though a gradual and judicious approach is the only pragmatic and feasible option at the present, this must be considered as a step towards the eventual elimination of all restrictions on cross-border capital flows and financial services." ✱

"More importantly, if integration is to succeed, governments and publics should believe that it is in their vital national interest. Without such commitment, regional groupings will crumble at the first bump in the long road to integration."

Fraser Cameron, Adjunct Professor at the Hertie School of Governance in Berlin and Senior Adviser at the European Policy Centre

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Case Study

REGIONALISATION CASE STUDY: MAYBANK

MAYBANK IS IN THE MIDST OF A BIG EXPANSION PUSH THAT FOCUSES INTENSIVELY ON PENETRATING REGIONAL ASEAN MARKETS. THE MALAYSIAN BANK IS CAPITALISING ON THE WINDOW OF LIBERALISATION AND INTEGRATION, NOT JUST BY BOOSTING ITS PRESENCE IN NEIGHBOURING COUNTRIES BUT ALSO BY STEPPING UP ON TECHNOLOGY AND ISLAMIC BANKING.

Regional expansion is the big push for Abdul Farid Alias, the new Chief Executive Officer of Malayan Banking Berhad or Maybank, Malaysia's largest banking group. As his predecessor Abdul Wahid Omar was named Head of the Prime Minister's Economic Planning Unit, Maybank wanted its next leader to be someone with "the courage to take some very bold decisions on how to move ahead of the competition," Maybank Chairman Tan Sri Dato' Megat Zaharuddin Megat Mohd Nor said at August's announcement.

"We believe greater regionalisation in our other businesses, in retail, community finance, insurance and asset management are the way forward," said Zaharuddin, as Maybank aspires to be a leading financial services group in the Association of Southeast Asian Nations (ASEAN) region. The company vowed to grow its pre-tax profits from international operations to about 40% by 2015, a notable jump up from the 30.2% level at the end of last year. In order to achieve this, Maybank will need to make at least one acquisition, meaning the hunt is on for a suitable takeover target.

Maybank expects its regionalisation to be primarily driven by its key markets of Indonesia and Singapore. However, the bank is also keen to grow its presence in the Philippines, Cambodia, Vietnam and China. Farid has expressed particular interest in pushing ahead in Thailand, deeming it an 'attractive' market. Having been Maybank's Deputy President and Head of Global Banking Business since July 2010, Farid needs little time to become familiar with his new charge, meaning an announcement that brings his intentions to life could come sooner rather than later.

Ambitious expansion plans

Maybank is Malaysia's biggest bank by assets and Southeast Asia's fourth largest lender. Maybank's last major push into ASEAN came in 2011, with the USD1.4bn acquisition of Kim Eng Holdings, a leading brokerage outfit in Singapore and the Philippines. Maybank Islamic is the largest provider of Islamic financial services in the region, not to mention being the world's 17th largest Islamic financial institution in terms of *Shariah*-compliant assets. Maybank also operates wholly-owned investment banking and insurance businesses, and holds a majority stake in Bank Internasional Indonesia (BII). The group is currently working to reduce its holding in BII from 97% to 80% to comply with regulatory requirements for free float of stock in the Jakarta-listed bank. Maybank also has interests in operations in locations further afield, including Pakistan and Papua New Guinea.

While Farid's appointment has given the regionalisation drive a shot in the arm, the bank's expansion plans do however pre-date the change in leadership; Maybank initiated its current transformation programme in July 2010. The bank has a five-point plan for becoming a 'regional financial services leader' by 2015, which reassuringly starts with ensuring a strong base in the Malaysian home market. That means continuing to push on with retail financing products such as home loans, car loans, credit cards, unit trust financing, and deposits for all types of individual customers, smaller businesses, and corporations. Goals include building an emerging regional insurance champion, as well as a regional investment bank with eventual expansion also to the Middle East, China and India. Lastly, Maybank intends to ensure a third of its domestic financing is backed by Islamic financial assets by 2015: "Our Islamic banking operations will focus on delivering innovative and globally accepted products and services that differentiate us from other Islamic financial institutions."

The bank progressed significantly with its global banking efforts last year, including delivering business platforms for seamless cash management and trade finance for corporate clients. The Regional Trade Finance Platform enables real-time trade processing for clients, having so far been rolled out to ten countries in Asia. The Regional Cash Management Platform has been deployed in Singapore and Malaysia, ensuring a standard approach to the cash management market, an area projected to be worth more than USD162bn by 2014, according to McKinsey. As the platform was launched, then-Head of Global Wholesale Banking Farid said it came in response to the needs of Maybank's regional clients, particularly in cash management and transaction banking. "In Malaysia, we have market share of over 40% of transaction volume and 37% transaction value," said Farid. "In Singapore and Indonesia, now we have the ability through this new system, to offer them comprehensive management of all their cash management and trade finance needs through one single platform for the region."

Progress was further illustrated when 'The Banker' issued its latest Top 100 rankings: Maybank made its first entry this year. The current 95th position is a significant jump from 134th last year. Maybank's Tier-1 capital stands at USD12.61bn, according to the rankings, along with an asset size of USD161.827bn, pre-tax profits of USD2.582bn, and a capital assets ratio of 7.97%. Asia-Pacific banks have been increasing their presence on the extended list, reaching 350 in numbers this year, compared to 321 in 2010. This is a significant lead on the 231 Western European banks on the list.

Maybank announced a USD100 million cash injection for its Philippines unit in October, in an effort to strengthen the local operations as they are benefiting from increased regional trade and investment flows. Present in the Philippines since 1997, Maybank has steadily boosted its operations in the country by streamlining its networks, investing in technology, and adding resources in terms of infrastructure and staff.

Indonesia, Singapore and beyond

As the region prepares for the ASEAN Economic Community (AEC) in 2015, Maybank wants to ensure it is one of the union's financial leaders: a well-connected and capitalised banking services provider, and a strong representative for Malaysia. The performance and progress of Maybank is a matter of national pride, as the bank is nearly 70% owned by public funds.

In August, Maybank Asset Management expanded operations to Indonesia by acquiring local peer PT GMT Aset Manajemen. "Despite the current volatile market conditions, we are here for the long-term as we are confident Indonesia will continue to outperform due to its strong domestically focused economy," said Nor' Azamin Salleh, Managing Director of Maybank Asset Management, following the announcement. He pointed to Indonesia being the region's largest economy and one of the fastest growing countries in ASEAN. "Our strategy is to first build our foundations in ASEAN, as we are familiar with its culture, business ethics and economy. Additionally, the formation of the ASEAN trading link platform would be an excellent conduit to tap the region's growth opportunities, as it allows investors easy access to a wider investment selection across connected markets."

Maybank announced a USD100 million cash injection for its Philippines unit in October, in an effort to strengthen the local operations as they are benefiting from increased regional trade and investment flows. Present in the Philippines since 1997, Maybank has steadily boosted its operations in the country by streamlining its networks, investing in technology, and adding resources in terms of infrastructure and staff. Furthermore, the bank is investing in electronic payments, cash management, investment banking and consumer banking.

Following on from 2011's acquisition of Kim Eng Holdings, Maybank is now planning to further develop its presence in the Philippines. One way the bank will be expanding in the country is by doubling its branch network to 100 in 2014, and then doubling again to

In customer-facing innovation, Maybank's new mobile banking application suite is said to be among the first to deliver personalisation features and connection to social media platforms to users. Interestingly, the app lets customers carry out transactions across regional borders, for example transferring funds from Singapore to Malaysia, or paying a bill in another country.

200 by 2016. In September, Maybank Philippines declared its intent to further expand its footprint on Mindanao Island, where the bank has nine branches and has planned a total of 25 branches. Following the announcement, Eric Montelibano, Head of Corporate Affairs at Maybank Philippines, Inc., said the revenue contribution of five of the branches in Mindanao already equalled the contribution of the operations in Visayas, which has more branches; the implication being that the area has significant growth potential.

Laos and Cambodia are among emerging ASEAN markets of particular interest for Maybank Asset Management, as these countries could represent significant opportunities as they are opening up their capital markets. Maybank has focused mostly on retail banking in these countries until now, but had voiced intent to roll out potential broking and capital market operations.

Push for services and *Shariah*

Earlier this autumn, Maybank Singapore announced a USD43 million IT contract with NTT Communication and Dimension Data, in a departure from the previous USD404 million IT deal covering the past decade. The decision will see a major infrastructure upgrade for the Singapore operations, in a move encouraged by regulators as it will reduce compliance and operational risk. The upgrade will also result in efficiencies in terms of cost and procedures, said Lim Kuo Siong, Head of IT and Virtual Banking at Maybank Singapore. The move leads up to Maybank's plans to launch a private cloud, which will also lead to better control over the group's data as it will be managed by Maybank staff instead of third parties. As the new IT contract covers only Singapore, not Malaysia, the bank is expected to announce a separate deal for the home market. However, the Singapore deal does support a move towards transforming business applications also in Maybank's home market.

In customer-facing innovation, Maybank's new mobile banking application suite is said to be among the first to deliver personalisation features and connection to social media platforms to users. Interestingly, the app lets customers carry out transactions across regional borders, for example transferring funds from Singapore to Malaysia, or paying a bill in another country. Personal features include the ability to add photos of savings goals, while location-based features help users locate nearby branches, cash machines and allied network services.

Maybank continues to push ahead in the field of Islamic finance, an area where the bank has already established itself as a leader, not just in the ASEAN region but globally. Singapore and Indonesia are first on the list for Maybank Islamic's internationalisation drive; the goal is to solidify its presence throughout the AEC area. Muzaffar Hisham, Chief Executive Officer of Maybank Islamic, saw the 2013 World Islamic Economic Forum in London as an opportunity to put on a 'charm offensive' and tell the 'real story' of Islamic banking. "There is still a lot of misconception about Islamic banking in the West. Some think it is only for Muslims and not as an alternative to conventional banking," Muzaffar told 'Business Times'.

As a case in point, Singapore is among countries having embraced *Shariah*-compliant banking despite not being a Muslim country. "Since 2010, our Islamic deposits have risen to S$1bn, mostly from non-Muslim customers. It's not only about *Sukuk* [Islamic bond] issuance, but other products too, such as financing for property purchases," said Muzaffar, adding how customers in Singapore are drawn to the humanising aspect of Islamic banking. Maybank Islamic is now interested in partnering with financial groups in Europe, appealing to customers either as a provider of alternatives for ethics-conscious investors, or simply as a sound economic investment regardless of religious considerations.

Time will tell how Maybank's ambitious expansion plans play out as it attempts to become not just the tiger of Malaya, but the top dog of ASEAN's financial services sector. ✱

■ Reporting by the *Banking Insight* Editorial Team.

Maturing
THE FINANCIAL LANDSCAPE

THE **FINANCIAL SERVICES ACT 2013** (FSA) IS AN UNPRECEDENTED AND WIDE-RANGING LEGISLATION DESIGNED TO ENHANCE FINANCIAL STABILITY AND EMPOWER BANK NEGARA MALAYSIA WITH INCREASED OVERSIGHT. THESE ARE QUALITIES WHICH WILL PLACE THE COUNTRY ON A STRONGER FOOTING EVEN AS IMPENDING INTEGRATION HEIGHTENS REGIONAL COMPETITION.

SAFIAH ASHEDOFF

Side-by-side with the new Islamic Financial Services Act 2013 (IFSA), the Financial Services Act 2013 (FSA) came into force on 30 June 2013.

The FSA is an omnibus legislation which consolidates the Banking and Financial Services Act 1989, Insurance Act 1996, Payment Systems Act 2003 and Exchange Control Act 1953. This extensive legislation gives unprecedented and wide-ranging regulatory and supervisory powers to Bank Negara Malaysia. Quality and competency are also cornerstones of the legislation which raises standards on prudential matters ranging from capital adequacy, risk management, liquidity, corporate governance, related party transactions to insurance funds amongst others as stipulated in Section 46 of the FSA.

With the FSA, Bank Negara Malaysia seeks to regulate all financial business including "banking business, investment banking business, financial intermediation business, factoring business and leasing business" as stated in Section 3 of the FSA; at the recommendation of Bank Negara Malaysia, the Minister may add any other business to this category. Minister within the meaning of the FSA is a Minister "for the time being charged with the responsibility for finance."

In a recent press statement, Bank Negara Malaysia stated that "the FSA and IFSA are the culmination of efforts to modernise the laws that govern the conduct and supervision of financial institutions in Malaysia to ensure that these laws continue to be relevant and effective to maintain financial stability, support inclusive growth in the financial system and the economy, as well as to provide adequate protection for consumers. The laws also provide Bank Negara Malaysia with the necessary regulatory and supervisory oversight powers to fulfil its broad mandate within a more complex and interconnected environment, given the regional and international nature of financial developments. This includes an increased focus on pre-emptive measures to address issues of concern within financial institutions that may affect the interests of depositors and policyholders, and the effective and efficient functioning of financial intermediation."

Section 6 of the FSA states that the "principal objective of this Act is to foster safety and soundness of financial institutions; the integrity and orderly functioning of the money market and foreign exchange market; safe, efficient and reliable payment systems and payment instruments; and fair, responsible and professional business conduct of financial

FSA

The FSA is an omnibus legislation which consolidates the Banking and Financial Services Act 1989, Insurance Act 1996, Payment Systems Act 2003 and Exchange Control Act 1953.

institutions; and strive to protect the rights and interests of consumers of financial services and products".

Note that failure by financial institutions to comply with the provisions of the FSA will result in a hefty fine, a penal sentence or both.

The new legislation is also anticipated to converge Malaysia with global best practice and standards. Writing in "The Financial Services Act 2013", former Bank Negara Malaysia Assistant Governor Gopal Sundaram stated that "An important development which began in the 80s, is the global convergence of capital requirements, followed by supervisory standards, payment system standards, anti-money laundering and counter terrorist financing standards, accounting standards, and lately Basel III on liquidity management standards. The proliferation of international soft legislation has necessitated a legislative framework which would enable a convenient means of reception and application of such international standards in Malaysia."

Impact of FSA's new measures

The FSA introduces key new measures that will have far-reaching implications on the banking and financial sector in Malaysia. These include:

- **The "Fit and Proper" requirement**

A financial institution shall only appoint a person to the position of "...chairman, director, chief executive officer, or senior officer…" if they qualify under the fit and proper requirement as provided under Section 60 of the FSA. These criteria relate to probity, personal integrity and reputation of the candidate, competency and capability and financial integrity. The FSA further gives power to Bank Negara Malaysia to decide on whether the person is "fit and proper" in the event of issues relating to this requirement.

It is imperative that the financial institution "removes or terminates" any member of the senior management and/or directors if they no longer qualify under the "fit and proper" requirement under the FSA and the terminated individual is not allowed to claim for any compensation pursuant to that termination.

This is a welcome move as removals or terminations in this regard will not expose a financial institution to industrial action and the associated impact on reputational risk.

- **Acquisition and interest in shares of a financial institution**

The new legislation seeks to streamline the approval process for acquisition by persons in a financial institution and ensure uniformity between financial institutions and insurance providers.

As with previous legislation, the prior approval of Bank Negara Malaysia is required before commencing any negotiations for acquiring a stake of 5% or more in the shares of a financial institution. However, any further acquisition does not require the approval of Bank Negara Malaysia as long as it does not exceed a multiple of 5% or the percentage holding for a mandatory offer as stipulated under the Malaysian Code on Take-Overs and Mergers as prescribed under Section 217 of the Capital Markets and Services Act 2007.

Notwithstanding the above legislative requirement, the FSA stipulates that no person may acquire more than a 50% interest in shares of a financial institution without prior approval of the Minister, after obtaining Bank Negara Malaysia's recommendation. Consequently, any further acquisition of shares above the 50% threshold does not require the approval of Bank Negara Malaysia or the Minister.

On the other hand, disposal of shares does not require approval of Bank Negara Malaysia or the Minister unless it is by a person who holds more than 50% of the shares or holds less than 50% but has controlling interest in the financial institution. The streamlining of these pertinent sections as compared to previous legislation will clearly make it easier for "licensed persons" as defined under the FSA and it is noteworthy that the single presence rule which had prohibited a "licensed person" from holding shares in more than one financial institution without having to merge both has been done away with.

A licensed person is defined in the FSA as "A person licensed under Section 10 to carry on a licensed business". Section 10 outlines the criteria required before a license is granted by the Minister of Finance by an applicant to be a "licensed business". The FSA defines a licensed business as a banking business, insurance business or investment banking business.

As such, a party may hold a substantial stake in two financial institutions without having to obtain prior approval from Bank Negara Malaysia as was the case for DBS Group in 2012 when its shareholder, Temasek Holdings sought to acquire shares in Alliance Bank Berhad, thus allowing it to hold stakes in both Alliance Bank Berhad and Hwang-DBS (M) Berhad.

- **Financial groups and holding companies**

A new concept that will impact holding companies is the requirement under the FSA to apply to be a "Financial Holding Company" to ensure the safety and financial soundness of the financial institutions under their control.

Any company holding more than a 50% share in a licensed person as defined under the FSA will be required to obtain approval from Bank Negara Malaysia to be approved as a financial holding company. Interestingly, Bank Negara Malaysia can approve another company within the Group which is in a better position to be the financial holding company for the licensed person for "the purposes of maintaining effective regulation and supervision of a licensed person."

Bank Negara Malaysia may also choose to approve more than one company within the Group to be listed and defined as a financial holding company for the purposes of the FSA.

Hitherto, the same stringent prudential requirement that applies to the licensed person will similarly apply to the financial holding company. Bank Negara Malaysia is also equipped with extensive power to direct the financial holding company pursuant to Section 116(3) of the FSA to, amongst others, dispose of its assets or investments, vary or terminate any agreements entered by the financial holding company or any of its subsidiaries, and prohibit the financial holding company from entering into any transactions and/or agreements.

The chairman, chief executive officer (CEO), directors and senior management will similarly be subject to the "fit and proper test" as the licensed person. These new legislative changes will transform the financial landscape in Malaysia and ensure that a robust and stable financial environment exists and thrives. Bank Negara Malaysia has the unprecedented power to regulate and monitor the activities of the financial holding company so that risky businesses and enterprises do not affect the financial soundness and bottom line of the licensed person.

The bridge institution will be sheltered and not liable for any past actions of the officers of the financial institution and Bank Negara Malaysia may choose to provide financial assistance to the bridge institution as it deems fit.

- **Assumption of control**

Bank Negara Malaysia may take control of a financial institution in the event the latter is deemed to be financially unstable, its asset quality is deteriorating or there are risk factors that will result in the said financial institution becoming insolvent or unable to manage its affairs.

Upon taking control of the financial institution, Bank Negara Malaysia will take custody and manage the financial institution until such a time that it revokes this in writing. During this crucial period, senior management as determined by Bank Negara Malaysia, the chairman, CEO and directors will be suspended until further notice without receiving any remuneration unless specified by Bank Negara Malaysia for services rendered at its request.

Bank Negara Malaysia may choose to appoint a bridge institution that will manage the running of the distressed financial institution. During this period, all legal proceedings, orders and/or judgement will be stayed as long as the bridge institution is in charge. The bridge institution will be sheltered and not liable for any past actions of the officers of the financial institution and Bank Negara Malaysia may choose to provide financial assistance to the bridge institution as it deems fit.

- **Payment systems**

Bank Negara Malaysia has the discretionary powers to specify standards for the operator of payment systems in order to ensure and promote the "safety, integrity, efficiency or reliability of the designated payment system" as specified under Section 32(1) of the FSA. The FSA further stipulates under subsection 32(2) that "an operator of a designated payment system, an approved operator of a payment system, a registered operator of a payment system or an approved issuer of a designated payment shall at all times comply with the standards specified by the Bank."

Bank Negara Malaysia has also been accorded the power to issue directions to financial institutions to use a specific payment systems operator in the event there is a risk to the management system.

An important change is the application

of prudential requirements and appointment of the senior management of the operator will be subject to approval of Bank Negara Malaysia. As such, appointments, reappointments, elections and re-elections of the chairman and CEO of the operator will similarly require Bank Negara Malaysia's approval.

Most importantly, operators must take cognisance of Section 155 that specifies that Bank Negara Malaysia "may issue one or more of the directions specified in Section 156 if the Bank is of the opinion that an institution, its director, CEO or senior officer has failed to ensure the safety, efficiency and reliability of the payment system or payment instrument, having regard, *inter alia,* to the reasonableness of admission criteria for participating in the payment system and the overall cost to the participants or users of, or any other persons involved with, the payment system or payment instrument."

Section 156 allows Bank Negara Malaysia to issue directions to the institution, its director, CEO or senior officer, to cease or refrain from committing an act or pursuing a course of conduct or to do any act, in relation to its business, affairs or property if Bank Negara Malaysia "is of the opinion that it is necessary to remedy any of the circumstances in Section 155."

These stringent oversight powers apply equally to financial institutions, insurance providers and payment systems operators.

- **Directors' duty to disclose**

The FSA has increased by a notch the level of scrutiny on the duties of disclosure by directors in an institution. A director of an institution will have to disclose to the board of directors any "interest" in a "material transaction" or "material arrangement that the institution is involved in", whether "directly or indirectly". He will have to then recuse himself from any board meetings that deliberate, discuss and/or decide on this material transaction or arrangement.

Bank Negara Malaysia may specify the definition of "material transaction" or "material arrangement" and what it constitutes.

Moving forward, it remains to be seen how the FSA will be invoked and used. It is useful and pertinent for institutions to keep Section 156 in mind wherein Bank Negara Malaysia has the power to issue directions to the extent of directing the affected institution to cease any agreements and/or arrangements that are viewed to contravene the stringent prudential requirements under Section 155; to dispose of all or any of the investments or assets held by the institution in any body corporate; to prohibit the institution from continuing with any part of its business; to prohibit the institution from entering into any financial arrangement; or to impose conditions thereto to ensure strict compliance.

By placing intense emphasis on compliance, prudential requirements, integrity, quality, accountability, and good corporate governance, the FSA will serve to strengthen the industry and place the country on a stronger footing even as impending integration heightens regional competition. ✱

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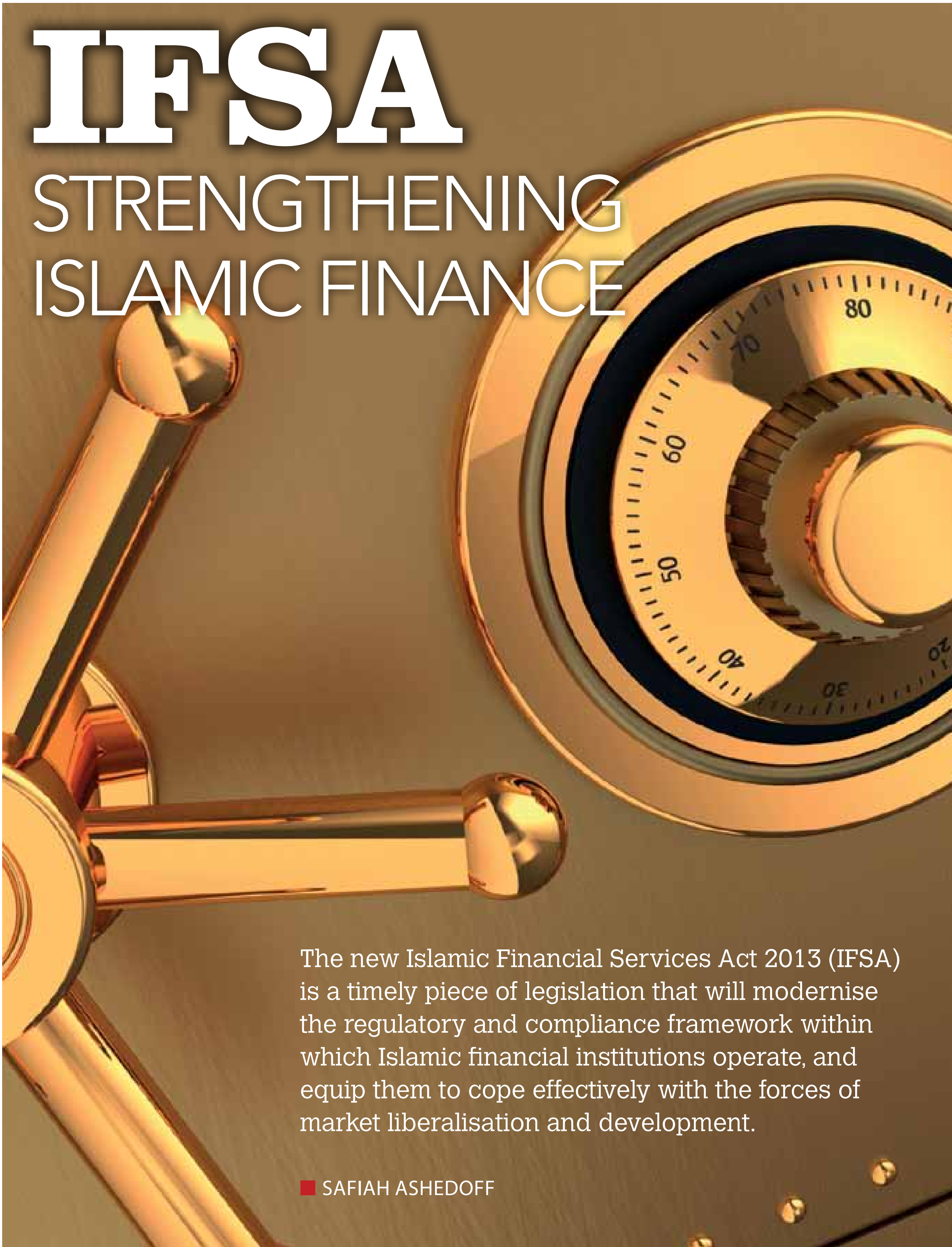

IFSA
STRENGTHENING ISLAMIC FINANCE

The new Islamic Financial Services Act 2013 (IFSA) is a timely piece of legislation that will modernise the regulatory and compliance framework within which Islamic financial institutions operate, and equip them to cope effectively with the forces of market liberalisation and development.

SAFIAH ASHEDOFF

Generic legislation and enforcement have long been stumbling blocks hindering the expansion and maturity of Islamic finance.

In an effort to modernise the regulatory and compliance framework within which Islamic financial institutions operate, Malaysia came up with the new Islamic Financial Services Act 2013 (IFSA) - an omnibus, extensive and wide-reaching Act that will give the Central Bank or Bank Negara Malaysia greater regulatory and compliance oversight. Replacing the Islamic Banking Act 1983 and *Takaful* Act 1984 which have been repealed, IFSA came into force on 30 June 2013 some seven months following Parliamentary approval.

IFSA is, arguably, one of the most comprehensive pieces of legislation governing Islamic finance in the world today, and should advance Malaysia's standing in the global industry. It is indeed timely that this legislation has come into force now in response to the rapid expansion and new developments affecting the Islamic finance industry in Malaysia and globally.

Governing both the regulatory and legislative operations of the Islamic banking business, *Takaful* operators, payment systems operators, Islamic financial advisors and *Takaful* brokers, IFSA empowers Bank Negara Malaysia with wider regulatory and supervisory powers to ensure regulatory compliance and good governance among Islamic financial institutions, while taking emerging risks and global best practices into account.

In a press statement on IFSA, Bank Negara Malaysia said: "It is important that Malaysia's regulatory and supervisory system is adequately equipped to respond effectively to new and emerging risks so that confidence in the financial system is preserved and that the critical financial intermediation activities which are vital to the economy are not disrupted."

What does IFSA do?

Perhaps the most striking feature of IFSA is the emphasis on *Shariah* compliance.

Bank Negara Malaysia states that IFSA is designed to provide "a clear focus on *Shariah* compliance and governance in the Islamic financial sector. In particular, IFSA provides a comprehensive legal framework that is fully consistent with *Shariah* in all aspects of regulation and supervision, from licensing to the winding-up of an institution."

Holistic in nature, IFSA addresses diverse concerns impacting Islamic finance. These range from *Shariah* governance, audits on *Shariah* compliance, corporate governance, transparency requirements, the standards and conduct of Islamic banks in the Islamic money and forex markets, specific provisions on winding-up of Islamic banks whether voluntary or non-voluntary, right up to the absolute power to remove senior management including the chief executive officer and assume control of the said Islamic bank.

Section 6 of IFSA spells out the regulatory objectives whereby Bank Negara Malaysia "shall foster:

- the safety and soundness of Islamic financial institutions;
- the integrity and orderly functioning of the Islamic money market and Islamic foreign exchange market;
- safe, efficient and reliable payment systems and Islamic payment instruments; and
- fair, responsible and professional business conduct of Islamic financial institutions and strive to protect the rights and interests of consumers of Islamic financial services and products."

It is indeed timely that this legislation has come into force now in response to the rapid expansion and new developments affecting the Islamic finance industry in Malaysia and globally.

Section 7 further expands on this whereby Bank Negara Malaysia has the unfettered power to do what it deems fit to ensure compliance of Section 6 above by appointing members, committees and competent persons to perform to ensure stringent compliance by Islamic banks. Take note that any breach of the Act will result in a penal sentence or a hefty fine.

The SAC's role is also to advise Bank Negara Malaysia and the Islamic bank concerned on any *Shariah* issues relating to Islamic financial business operations, activities and/or transactions.

Historical development of IFSA

It could be said that IFSA has come into being specifically to address the needs and concerns of the Islamic banking sector.

While Malaysia did have legislation for Islamic finance in the form of the now-defunct Islamic Banking Act 1983, the latter was essentially a mirror of the Banking and Financial Institutions Act 1989 (BAFIA) in terms of regulatory compliance and spelling out the code of conduct and operations for an Islamic bank. The only additional requirement under the previous act was for an Islamic bank to put in place a *Shariah* Committee to ensure compliance and governance of its business and/or operations conformed with *Shariah* principles.

While earlier legislation was not perfect, it paved the way for the unfettered and rapid growth of the Islamic finance industry which was a boon for the Malaysian banking industry as a whole. It cannot be denied that Islamic finance in Malaysia has been acknowledged for introducing innovative and sometimes controversial new ideas in the form of cutting-edge financial structures and award-winning deals, for example, in *Sukuk*.

Strengthening *Shariah*

The industry advanced further when in May 1997, Bank Negara Malaysia's Shariah Advisory Council (SAC) was set up and appointed as the highest authority governing Islamic finance in Malaysia. On its website, Bank Negara Malaysia states that SAC is the final authority that decides on Islamic law matters governing Islamic banking, *Takaful* and any other business and/or industry that operates based on *Shariah* principles and is regulated by Bank Negara Malaysia.

The Central Bank of Malaysia Act 2009 accorded more authority to the SAC by making it the sole authority for resolution of all *Shariah* issues for the Islamic finance and *Takaful* industry. If different *Shariah* Committees differ and issue contradictory pronouncements, any decisions made by SAC pertaining to the dispute shall be binding. In addition, the SAC advises Bank Negara Malaysia on any *Shariah* issue relating to Islamic financial business or transactions of Bank Negara Malaysia as well as other related entities.

In 2011, Bank Negara Malaysia issued Guidelines on *Shariah* Governance Framework for Islamic Financial Institutions (the Guidelines) whereby it stated that "comprehensive compliance with *Shariah* principles would bring confidence to the general public and the financial markets on the credibility of Islamic finance operations."

The Guidelines further espouse that the mandates of the SAC, among others, are to ascertain the relevant Islamic law on any financial matter and issue a ruling upon reference being made to it. The SAC's role is also to advise Bank Negara Malaysia and the Islamic bank concerned on any *Shariah* issues relating to Islamic financial business operations, activities and/or transactions.

The Guidelines further stressed the need for Islamic banks to have "a sound and robust *Shariah* governance framework that is reflected by an effective and responsible board and management, an independent *Shariah* Committee that is both competent and accountable, supported by a strong internal *Shariah* research capacity, and monitored through active *Shariah* review, *Shariah* audit and *Shariah* risk management process."

These requirements to conduct continuous reviews of *Shariah* compliance, *Shariah* audits and enhance the risk management process proved to further strengthen the existing framework of Islamic banks in Malaysia.

Since *Shariah* compliance is so integral to building the credibility and confidence of Islamic finance, it is hardly surprising that *Shariah* governance is heavily stressed in IFSA. Among the policies and procedures related to *Shariah* which are further expanded in the IFSA is the competence and professionalism of *Shariah* Committee members. Bank Negara Malaysia can compel Islamic banks to appoint competent *Shariah* Committee members; however, these members may be removed at any time if they are deemed to be "not fit and proper" under the definition of IFSA. Any appointment of a *Shariah* Committee member must obtain Bank Negara Malaysia's approval. Conversely, an Islamic bank cannot remove and/or terminate a *Shariah* Committee member without prior approval from Bank Negara Malaysia. The only exception to this rule is if the member resigns, is disqualified pursuant to any requirements set out in IFSA or fails the "fit and proper" test.

It is worth noting that competence is not limited only to *Shariah* Committee members. The "fit and proper" test applies to the chairman, chief executive officer, board of directors and senior management of the Islamic bank as well.

In order to protect the independence of *Shariah* Committee members and enable them to discharge their duties effectively, it is important to note that Section 36 of IFSA accords qualified privilege and confidentiality on the member wherein "a member …shall not be liable for a breach of confidentiality between the member and the institution in respect of -

It is worth noting that competence is not limited only to *Shariah* Committee members. The "fit and proper" test applies to the chairman, chief executive officer, board of directors and senior management of the Islamic bank as well.

a. any reporting to the Bank; or

b. the discharge of his duties and performance of his functions, pursuant to the standards specified by the Bank ...which was done…in good faith." Here, the "institution" refers to the Islamic bank and "the Bank" refers to Bank Negara Malaysia.

While the new legislation might be more draconian, it strives to preserve the independence and professional scepticism of *Shariah* Committee members. They cannot be sued for defamation either for any statements made without malice and in discharging their duties as a *Shariah* Committee member under IFSA.

This accords some comfort and relief for *Shariah* Committee members in ensuring that they are truly independent in their duties and not obligated to 'sweep anything under the carpet', as it were, for fear of repercussions from their employers.

The onus for *Shariah* governance lies on the banks. Section 28 of the IFSA places express requirements on all Islamic banks to notify Bank Negara Malaysia or its *Shariah* Committee members when the Islamic bank, "becomes aware that it is carrying on any of its business, affair or activity in a manner which is not in compliance with *Shariah*..", cease the said non-*Shariah* compliant activity and within thirty days thereof, submit a plan to rectify the *Shariah* non-compliant activity. Thereafter, Bank Negara Malaysia will conduct an assessment to ensure rectification was carried out.

The penalty for breaching this provision is a jail term not exceeding eight years or a fine not exceeding RM25 million or both. Interestingly, Section 11 (3) specifically states a banking business and a *Takaful* operator must have a professional indemnity cover whereby, the quantum is specified by Bank Negara Malaysia. In the event of failure thereof and upon conviction, the bank or *Takaful* operator will be liable to imprisonment for a term not exceeding five years or to a fine not exceeding RM10 million or to both.

By escalating the requirements for *Shariah* governance, Bank Negara Malaysia aims to ensure proper measures, operating procedures and guidelines are put in place at every level of the Islamic financial institution to improve risk management and flag out risks early so they can be rectified quickly without compromising reputations and market confidence.

Assurance is also key to the revisions incorporated into IFSA. The new legislation vests Bank Negara Malaysia with new powers to ensure a proper *Shariah* audit is conducted as specified in Section 37 and 38 of IFSA. Failing this, Bank Negara Malaysia may appoint a person to perform an audit on *Shariah* compliance in the event the Islamic bank in question fails to do so or Bank Negara Malaysia opines that an external appointment is still required, over and above, the internal appointment of an auditor by the Islamic bank.

The IFSA further emphasises the importance of assurance and strengthens the position of auditors. The person appointed under Section 37 and 38 of the IFSA to carry out an audit shall submit a report to Bank Negara Malaysia on the audit carried out on the Islamic bank being scrutinised. The person appointed shall also not be liable for a breach of duty or confidentiality to the Islamic bank being audited for any matters that he or she may report to Bank Negara Malaysia pursuant to the *Shariah* audit.

Improving oversight over financial holding companies; protecting stakeholders

Other than expanding Bank Negara Malaysia's regulatory and supervisory powers, the IFSA incorporates new stringent measures including the introduction of oversight power over financial holding companies. Pre-IFSA, this regulatory oversight was limited to financial institutions under the purview of Bank Negara Malaysia and did not extend to their holding companies. Once the parallel and new Financial Services Act 2013 (FSA) is in force, all holding companies that own more than 50% of any banks will come under the purview of Bank Negara Malaysia. This ruling is set to affect some of Malaysia's most powerful corporations. For example, DRB-HICOM BHD which owns more than 50% of Bank Muamalat Bhd will fall within the ambit of this legislation and will have to comply with IFSA provisions.

IFSA also seeks to address operational issues on payment system providers, and as such financial intermediaries and system providers too will come under the purview of Bank Negara Malaysia.

In its press release pertaining to the FSA and IFSA, Bank Negara Malaysia said: "Provisions to regulate financial holding companies and non-regulated entities take account of systemic risks that can emerge from the interaction between regulated and unregulated institutions, activities and markets. The Minister of Finance may subject an institution that engages in financial intermediation activities to ongoing regulation and supervision by Bank Negara Malaysia if it poses or is likely to pose a risk to overall financial stability."

The supervisory and regulatory powers governing these providers will allow Bank Negara Malaysia to appoint and choose a payment system with the agreement of the Minister of Finance, assuming Bank Negara Malaysia thinks that there may be a disruption of operation of a payment system that will "affect public confidence in the overall payment system in Malaysia or impact the monetary or financial stability" of the country.

Some final thoughts

While the full impact of IFSA can hardly be encapsulated in these few pages, it is safe to say that this far-reaching legislation is comprehensive, detailed and tailored to meet the unique requirements of the Islamic finance industry as it seeks further growth. IFSA will govern virtually every aspect of an Islamic financial institution – whether operations, corporate governance, prudential requirements and risk management, to name a few - and will provide legislative strength and credence to the financial sector and the Islamic finance industry.

The challenge here is for Islamic finance players and the people involved to accelerate their competencies and competitiveness in order to heighten compliance with regulatory policies and procedures and achieve the financial stability and maturity which is the ultimate outcome desired by IFSA. It is especially important for Islamic finance to build up credibility and good governance to compete with conventional finance as both sides seek to make inroads into the massive regional markets opening up due to ASEAN integration. ✱

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EXPORTING ISLAMIC FINANCE - *Risks and Rewards*

WHAT DOES ASEAN INTEGRATION HOLD FOR **ISLAMIC FINANCE (IF)?** LEADING PLAYERS IN THE MALAYSIAN **IF** SECTOR SHARE THEIR THOUGHTS ON THE PROSPECTS AND CHALLENGES OF EXPORTING ISLAMIC FINANCE SERVICES ACROSS THE BORDER.

DALILA ABU BAKAR

The prospective establishment of the ASEAN Economic Community (AEC) by 2015 heralds the emergence of a regional integrated market comprising over 600 million people and offering ample economic opportunities. Financial services in particular, such as Islamic finance (IF), look poised to shine in this new borderless market. Indeed, IF's increasing regional participation is in sync with Bank Negara Malaysia's vision as proposed in its 10-Year Financial Sector Blueprint 2011-2020.

For some players, regionalisation is a chance to export new ideas and ethical principles, and to sustain rapid growth. Dato' Mohd Redza Shah Abdul Wahid, Chief Executive Officer of Bank Muamalat Malaysia Bhd said: "Over the last few years, Islamic banking has been growing at a faster rate than conventional banking and is increasingly becoming an attractive form of financial intermediation. Positive developments towards greater integration with the broader financial system will not only allow Islamic banks to attract people who have not been exposed to this kind of services before but also provide a platform to generate greater trade and wealth creation and at the same time allow for greater distribution of risk and contribute towards greater flexibility."

"Regionalisation offers huge opportunities to Islamic banking. Obviously, regionalisation will offer access to a broader client and asset base besides promoting ethical banking among ASEAN members, hopefully with more relaxed regulations and policies imposed by the countries' regulators. And as these markets develop, more corporates will have growing banking needs that could be served via the Islamic capital markets and investment banking, such as *Sukuk* financing," he continued.

Disparate markets for Islamic finance

Apart from the AEC, another regionalisation initiative which could prove beneficial for Islamic finance is the Trans-Pacific Partnership Agreement (TPPA), which has a bigger footprint. At the time of writing, the TPPA is set to include the United States, Australia, Brunei, Chile, Malaysia, New Zealand, Peru, Singapore, Vietnam, Mexico and Canada. "Together with the AEC countries, this could result in a vastly expanded market for Islamic banking. We foresee North America as an important regional market. Nearer to Malaysia, opportunities still abound in some countries in ASEAN especially Indonesia, Thailand and Vietnam," said Prof. Dr. Saiful Azhar Rosly, Head of Consulting and Executive Programmes at INCEIF or the International Centre For Education In Islamic Finance.

Financial services in particular, such as Islamic finance (IF), look poised to shine in this new borderless market.

Six of the ten ASEAN countries have already started developing their Islamic banking and finance sectors, while the other four - Cambodia, Laos, Myanmar and Vietnam have expressed their interest in Islamic finance.

Indonesia, given its large Muslim population with low penetration in Islamic finance could be the most attractive market, mused Saiful. "But overall, ASEAN could also offer potential for financing, capital raising or even *Waqf* development towards development in infrastructure, education and health as these sectors are crucial for economic development and still lacking in some of the ASEAN countries."

Under the TPPA, Malaysia should become an integral part of the greater economic integration and will have more access to products and services as well as bigger markets. The TPPA is also anticipated to pave the way for more structured trade arrangements expected to take place between Malaysian companies and their counterparts in the United States, Australia and Canada.

Six of the ten ASEAN countries have already started developing their Islamic banking and finance sectors, while the other four - Cambodia, Laos, Myanmar and Vietnam have expressed their interest in Islamic finance.

But all is not plain sailing with the TPPA, which has come under fire from many quarters. "Malaysia has not made its stance on the TPPA and we are worried about whether the *Shariah* structure will be acceptable within the member countries of TPPA. We are worried about the restricted governance that will not allow the free flow of Islamic banking services, because we are a bit cautious about conventional banking which dominates the current market," explained Datuk Mohamed Azahari Kamil, Chief Executive Officer of Asian Finance Bank Bhd.

Within the TPPA footprint, Brunei, Singapore, Malaysia and Vietnam are considered Islamic banking markets. Meanwhile, enforcement and legislation to support Islamic finance are not yet in place in developed markets such as the United States and Australia.

Regionalisation risks

While regionalisation offers opportunities such as the building of market bases and new distribution channels and testing of new products, there are definitely risks such as credit risk, market risk, operational risk, *Shariah* risk, ownership risk, investment risk and liquidity risk, to name just some.

Among the key challenges of regionalisation is "*Shariah* structure uniformity as we want to make sure that we talk the same language. An example is the *Sukuk* problem and Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) accreditation as some of the *Sukuk* are not accredited; hence, we can't tap the Middle East markets," remarked Azahari.

Legislation and enforcement were pinpointed as fundamental areas for improvement. "Without legislation, there will be cowboy management," said Azahari. "Bridging regulatory and supervisory gaps as well as interpretations of *Shariah* law is essential at this juncture before we can truly realise the objective of regionalisation," said Mohd Redza Shah.

Although the industry is maturing, legislation still lags and there is market disparity. "Even in countries where Islamic banking has been accepted as part of the financial landscape, there remain legislative/jurisdictional issues that need attending to," said Saiful. This is particularly true of cross-border legislation and jurisdiction which is an enlarged area of concern for Islamic banks. Furthermore, the regulatory framework is complicated by the various bodies supervising Islamic banking like the central banks, Islamic Financial Services Board (IFSB) and accounting bodies like AAOIFI. Interpretation, understanding and implementation of the rules, guidelines and procedures governing Islamic finance are conditioned by the local environment, culture, economic systems and available institutional frameworks. To address these, said Saiful, Islamic finance needs a holistic approach to legislation, jurisdiction and supervisory challenges. "Engagement of the relevant stakeholders, e.g. central banks, regulators, government and market players are required to address challenges of regionalisation."

It is not only essential to have up-to-date integrated systems, but these systems must also be able to support Shariah requirements and the complexity of Islamic banking products while satisfying the enlarged customer bases from expansion.

Like other segments of the banking sector, IF faces technology risk. It is not only essential to have up-to-date integrated systems, but these systems must also be able to support *Shariah* requirements and the complexity of Islamic banking products while satisfying the enlarged customer bases from expansion.

The inherent complexity of Islamic banking products and services meanwhile require special skill sets and knowledge to market and explain them to clients. Islamic banking products are inherently more complex than their conventional counterparts; having to avoid *Riba* (interest), *Gharar* (uncertainty), and *Maisir* (gambling) will carry significantly different types of risks. In an environment where risk management rules are being elevated, Islamic banks will require much more detailed risk profiles to ensure that they can absorb any internal or external shocks in the process of going regional.

Islamic financial institutions also need to strengthen their capital. "Any form of expansion including regionalisation will require an expanded capital base for Islamic banks. Although most Islamic banks are currently well-capitalised within the environment in which they are doing business, there is a great need to establish mega Islamic banks that can compete with the likes of Barclays, Citibank and HSBC. This is critical especially in the area of *Sukuk* IPOs and Islamic infrastructure project financing," Saiful said.

Liquidity management remains a stumbling block even in the more matured Islamic markets. Financial and economic crises have often created liquidity problems to Islamic banks, but the sector is working to improve liquidity. The Bahrain-based International Islamic Financial Market (IIFM) and International Swaps and Derivatives Association (ISDA) have been instrumental in providing the infrastructure for derivatives to be utilised by Islamic financial institutions for hedging purposes. For instance, ISDA in conjunction with IIFM announced the creation of the *Mubadalatul Arbaah* or profit rate swap, product standard to be used for Islamic hedging purposes in 2012. The International Islamic Liquidity Management Corporation (IILM) is also playing a role in providing liquidity to Islamic financial institutions and issued its maiden USD490 million 3-month *Sukuk* in Kuala Lumpur recently.

The bankers also zeroed in on the talent challenge for the Islamic finance sector. Talent at certain levels, especially at the mid-to-senior level of management, is still lacking. Similarly, certain key areas in Islamic finance such as Islamic capital markets, corporate banking, risk management, and actuarial in *Takaful* continue to rely on talent supplied by the conventional finance sector. IF must have access to "a high breed of talent management which can integrate talent and culture" in order to succeed, commented Azahari.

Beyond profit

At the end of the day, do the rewards outweigh the risks? It is also worth considering that Islamic finance institutions are not merely committed to the mandate of increasing shareholder returns, but may also want to do good in line with Islamic principles of giving back to society.

Financial inclusion – which is an objective for ASEAN regulators in harmonising markets which are currently disparate - could be a positive offshoot of expanding Islamic finance services. Islamic banking could be a catalyst for expanding wealth distribution via *Zakat* (tithe), *Waqf* (endowment) and corporate social responsibility activities, noted Mohd Redza Shah of Muamalat.

"These are the 'ethical' elements that Islamic banks can offer. Yes, we may experience a small loss in profit especially when the landscape is very competitive but it is more of getting the 'Barakah' or blessing by being involved in regionalisation activities."✱

■ Dalila Abu Bakar is a freelance writer based in Kuala Lumpur specialising in Islamic finance.

Industry Insights

Muzaffar Hisham, Chief Executive Officer of Maybank Islamic Bhd

"**Maybank Islamic,** the leading regional Islamic financial services provider, is very much at the heart of ASEAN by virtue of our core market reach in Malaysia, Indonesia and Singapore.

With our asset size now above RM100bn and pre-tax profit breaching the RM1bn mark last year (RM1.19bn in 2012), Maybank Islamic has benefited from regulatory stability and progress within our ASEAN core markets. We note that regulators have embarked on dynamic and pro-active strategies to ensure that the Islamic banking industry is at a level playing field especially within the taxation treatment of an Islamic transaction. This will of course provide an impetus to Islamic banks, including Maybank Islamic, which will be able to offer their products and services at more competitive rates to clients.

We do also recognise that regulatory reciprocity between countries of interest is essential for Islamic banking's future growth. A clear example lies within the recent development of the industry's infrastructure in Hong Kong.

The proposed ASEAN Economic Community will approximately have a demographic size in excess of 600 million people. This is a positive development for the region given that ASEAN (the future AEC) should be yielding a GDP growth rate averaging 5.5% over the next five years which will result in increasing demand for financial services. We do, however, have to learn from the lessons demonstrated by the European Debt Crisis as to whether it would be practical for AEC to establish a common monetary and fiscal policy. We believe that a strong AEC is essential for trade, growth and investments flows. It also provides a sound platform for the grouping to ascertain whether it would be feasible to have a common monetary policy sometime in the future.

From Maybank Islamic's perspective, enabling fair competition and harmonised financial policies are important issues to be addressed given the competitive nature of the current global economy. Being able to participate in a liberalised economic community will only enhance the competencies of Malaysian institutions and more importantly Islamic banking and finance."

The key to successful financial systems in this century therefore will be developing high-performing finance professionals through quality learning.

DRIVING QUALITY ASSURANCE THROUGH ACCREDITATION

HIGH QUALITY TALENT WILL GIVE BANKS A COMPETITIVE EDGE AS MARKETS BECOME MORE BORDERLESS. ACCREDITATION OF LEARNING PROGRAMMES IS KEY TO DELIVERING THE QUALITY LEARNING NEEDED TO UPSKILL HUMAN CAPITAL IN THE RACE TO REGIONALISATION.

DR. AMAT TAAP MANSHOR

Employee training and development is an important factor for most industries as it keeps employee and organisational goals aligned. It also serves as an added layer of assurance for the financial services sector in particular where systemic changes in recent decades have been transformational.

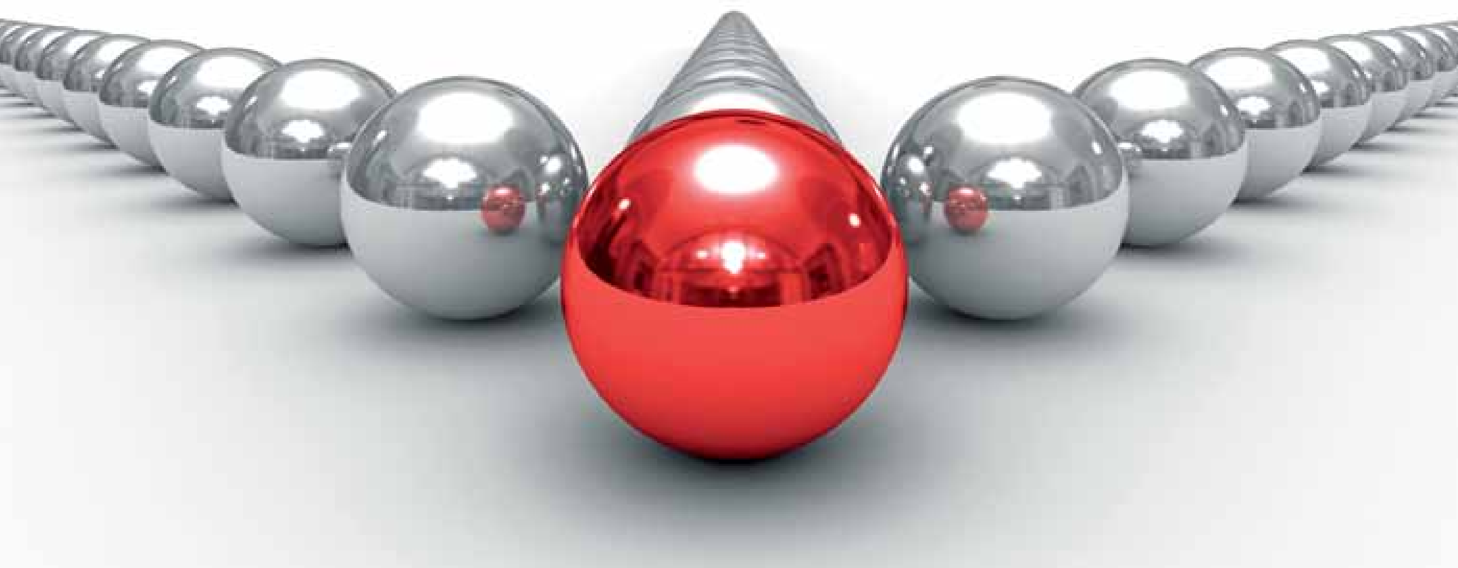
Dynamic regulatory standards, a high employee turnover rate, technical advancements and a rapidly expanding workforce spread across multiple financial sectors have made it critical for training providers to develop and maintain quality training for the industry to excel. The key to successful financial systems in this century therefore will be developing high-performing finance professionals through quality learning.

In effect, there will be only one overriding challenge for financial institutions. That is to stay disciplined and remain attentive to the transformational changes that force them to address the issues of quality talent in the workforce, so as to remain competitive. In addition, having documented proof of employee training such as accredited learning programmes is important for any regulated industry.

What is accreditation?

Many stakeholders today - whether they are service providers, regulators, training institutions and trainees themselves - often seek credentialing or special recognition by an external agency or body which 'confers' a 'seal of approval' for quality services provided to customers or clients. This 'seal of approval' in training for the Financial Services Industry (FSI) takes the form of accreditation.

Accreditation is a significant achievement pronouncing high-quality learning as well as an enhancement process for the FSI in terms of quality and performance of staff. It is in essence a status granted to an institution, its learning programmes and individuals that meet the prescribed criteria of quality. Specifically, the Finance Accreditation Agency (FAA) grants accreditation to learning programmes and training providers that meet the criteria stipulated in the FAA Quality Framework. In addition, through the development of the FAA Qualification Structure (FQS) and FAA Recognition of Prior Learning (FRL) initiatives, FAA ensures that the FSI is able to chart a clear career and development path for its staff. Ultimately, FAA also serves as an advocate for the provision of the highest quality assurance standards in the development of talent for the FSI.



How does accreditation improve quality in the FSI?

FAA conducts its activities in the following categories:

i) Development of the FAA Qualification Framework

The FAA Qualification Framework (FQF) is a comprehensive quality assurance framework with certification and accreditation systems that aim to raise the quality of talent belonging to the FSI. A major component of the quality assurance and accreditation initiatives of FAA by which the FAA Learning Criteria is established, the FQF forms a uniform approach to quality assessment of learning standards required in the quality assurance and accreditation process. One of the objectives of the FQF is to enhance the competencies of FSI employees through accredited learning programmes.

ii) FAA Learning Criteria

The FAA Learning Criteria (FLC) comprise the standards adopted to evaluate the learning programmes. In this context, the six (6) dimensions of the learning criteria are used as a basis for accreditation by which the learning programmes are submitted for FAA Approval, FAA Provisional Accreditation and FAA Full Accreditation. Each dimension represents an essential component of quality in the learning programme effectiveness of a training provider. To achieve quality and obtain FAA accreditation, it is essential that the minimum threshold of all the dimensions is met.

Accreditation is a significant achievement pronouncing high-quality learning as well as an enhancement process for the FSI in terms of quality and performance of staff.

iii) Development of FAA Learning Standards

A commitment to quality coupled with the development and application of standards are fundamental to providing quality learning. Standards and criteria are the vehicles by which the general concepts and attributes of quality learning are translated, understood and accurately measured. FAA is recognised to ensure high-quality assurance and accreditation practices in accordance with global standards and practices. Through the development of its own learning standards for focal areas in every sector in the FSI, which is benchmarked and moderated internationally, FAA ensures that the design, development, delivery and accreditation of a learning programme in terms of its levelling and contents are appropriate and useful. This integration of FAA Learning Standards (FLS) contributes to the improvement of learning quality that enhances the competencies of FSI employees through accredited learning programmes.

TRANSPARENCY, ACCOUNTABILITY AND THE GENERIC PRINCIPLES UNDERPINNING

All learning programmes and institutions accredited by FAA are subject to quality reviews when the validity period of accreditation is about to expire.

iv) Development of the FAA Qualification Structure

FAA is developing its Qualification Structure which aims to harmonise and integrate formal and professional qualifications with recognition of prior learning in the FSI into a single framework. The integration of all learning programmes and qualifications into the Qualification Structure will enable mutual recognition from other accreditation bodies locally and abroad, facilitating the mobility of FSI employees both in terms of career progression and academic advancement. The qualification structure which will be completed in 2014 will greatly enhance the professional development of talents in the FSI.

v) FAA Recognition of Prior Learning

FAA Recognition of Prior Learning (FRL) is critical to the development of an open, accessible, inclusive, integrated and relevant post-compulsory education and training system, and is the key foundation for lifelong learning policies that encourage individuals to participate in learning pathways that include formal, non-formal and informal learning.

vi) Industry Technical Experts

The FAA Accreditation Panel (FAP) appointed by FAA consists of subject matter experts in the FSI, locally and abroad, in their respective fields i.e. Islamic finance, insurance, capital markets, conventional banking and corporate programmes. FAP's role is to ensure that the learning programmes submitted for accreditation are in compliance with the FLC prescribed under the FQF and are relevant to the requirements of the FSI. Making appropriate recommendations to the FAA Technical Committee on the status of learning programmes, the FAP provides comprehensive and evidence-based analysis of the skills required which align to industry needs.

vii) Quality Reviews

All learning programmes and institutions accredited by FAA are subject to quality reviews when the validity period of accreditation is about to expire. Whilst the documentation of ongoing quality activities is still an integral part of the accreditation

THE PROCESS OF QUALITY ASSURANCE PRACTICED BY FAA ARE CRITICAL IN THIS INSTANCE.

process, FAA reviews how the institution addresses the FLC, not only after the accreditation is obtained but also when the learning programme is delivered. This allows for retrospective, concurrent and prospective reviews that emphasise on the desired outcomes by the financial institutions. Such an outcome-oriented approach, which focuses on the competencies of practitioners rather than on paper compliance, is essential to advance the mandate of FAA in facilitating the development of quality talent for the FSI.

viii) Trends in Learning and Training

The FQF results in the development of more learner-centred and skills-based learning programmes. FAA adopts a systematic review from the literature to the delivery and learning outcomes to evaluate whether the learning programmes of an institution warrant the training and fit the needs of the financial institutions. Its accreditation principles - such as being up-to-date and industry-based, and its flexibility model – ensure further that the specific training needs are met to build a competent and strong workforce that contributes to better financial products and services.

ix) Fulfilling the quality assurance function independently

To advance the overall delivery of high quality learning for the FSI, the need to promote increased industry and public trust in financial institutions must not be overlooked. Having a strong, credible and transparent system for structured assessment and accreditation is an essential building block of

the internationally benchmarked system to address quality talent. Transparency, accountability and the generic principles underpinning the process of quality assurance practiced by FAA are critical in this instance. FAA engages independent panellists to assess the learning programmes. Panellists who are the subject matter experts in the FSI are required to declare and fully disclose the conflict of interests which withholds him/her from making a fair judgement. Similarly, FAA does not involve itself in the design, development and delivery processes. The accreditation process pledged by FAA in this regard is independent and transparent and the accreditation decisions are therefore impartial and free from undue conflict of interest.

FAA has the responsibility to deliver quality excellence in the process of talent development through its rigorous accreditation process that ensures the quality of a programme, institution and the competencies of an individual. It serves as an advocate for the provision of high-quality assurance of learning standards through the development of nationally and internationally recognised standards. Through the accreditation process, FAA provides national and international financial institutions and practitioners with an effective way to regularly and consistently examine and improve the quality of learning offered to financial institutions. The shift in accreditation emphasis – from a facility which can provide high quality services to whether it actually does – has become the major focus in recent development and will continue to be emphasised until quality learning which addresses the knowledge and skills required is firmly incorporated into the accreditation process to strengthen the human capital of the FSI. ✱

■ Dr. Amat Taap Manshor is the Chief Executive Officer of the Finance Accreditation Agency.

Rethinking the education agenda

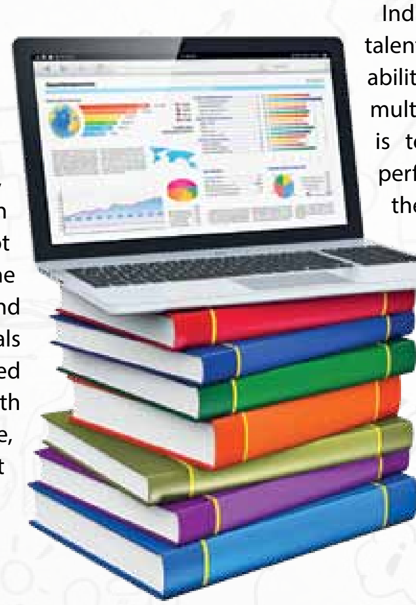
BANKS HAVE TO DISCARD THEIR BUSINESS-AS-USUAL APPROACH TOWARDS TRAINING AND RETHINK THEIR EDUCATION AGENDA TO MEET THE STRATEGIC DEMANDS OF AN INDUSTRY AND MARKETPLACE WHICH IS RAPIDLY CHANGING AND LIBERALISING.

TAY KAY LUAN

Banks are grappling with how to evolve given the challenges of changing consumer demands, increased regulation and, equally important, a rapidly shifting but very disruptive technological environment. Innovations in banking delivery are not likely to lose momentum; there has been noticeable growth in online banking including mobile applications.

Such a rapidly changing environment has provided an opportunity for banks to review and articulate the way they prepare their talent for their increasingly complex and challenging careers. It is well-known that banks face challenges to acquire the right talent to meet business needs. Training departments in banks are also wrestling with the issues of how to equip their people with problem-solving abilities and the skills to interpret information and communicate effectively in an ever-changing regulated environment.

Banks will continue to consolidate their business within their expanding markets, but their future growth plans will be in jeopardy if emerging talent issues are not addressed urgently and differently. The traditional approach to producing talent and managing the future pipeline of potentials has not kept ahead of the aforementioned changes, resulting in a talent shortage with serious consequences for banks. For example, they are hard pressed for good talent in implementing Basel III, International Financial Reporting Standards (IFRS), and Foreign Account Trade Compliance Act (FATCA) to name a few, to support the regulatory demands in managing risk or compliance. Coupled with a rising squeeze in margins, banks will need to rethink and reposition the way talent is being developed in order to remain competitive. And they need to do this in a hurry to beat the market.



New agenda

The training agenda has changed. Faced with the rapidly-changing needs of the market, it is no longer enough to maintain a business-as-usual approach towards training. A wider training agenda is necessary to meet the strategic demands of the industry. Feedback from regulators and industry leaders strongly affirm market observations that changes are imminent. Immediate challenges identified in a number of policy papers also agree that changes to training development and delivery are inevitable, and the need to re-align these to support the talent management agenda has become urgent.

Industry expectations also demand that future talent must possess global perspectives and the ability to relate and integrate current issues in a multi-disciplinary environment. The challenge is to ensure learners of today understand performance and learning needs and how these impact on their business outcomes. It is therefore not surprising that learning application and delivery have to be realigned to ensure industry relevance.

It is in this context that the Institute of Bankers Malaysia (IBBM) – which has been responsible for industry certification and training programmes since 1977 - has started to rethink on the future of education agenda for banks.

Jeopardy

Banks will continue to consolidate their business within their expanding markets, but their future growth plans will be in jeopardy if emerging talent issues are not addressed urgently and differently.

Asian Banking School

To meet these challenges a number of sweeping reforms are already taking place both inside and outside the banking institute. The establishment of the Asian Banking School is one of the key outcomes of the transformation efforts. Support from both the industry and the central bank, Bank Negara Malaysia, is positive, and this is critical to the agenda of ensuring a realignment of the education content and delivery to meet industry needs.

Content development

The goals are to ensure the industry has a more holistic approach towards executive education that is more discernible, and one that focuses on learning outcomes which empower banking professionals with the flexibility and the opportunity to gain easy access to world class education. The focus then is really on establishing a highly regarded and reputable institution capable of collaborating with the best in the industry and possessing its own capacity to deliver world-class education and training. The result will be agile talent able to navigate the complexities of a competitive yet regulated industry.

The Asian Banking School, to be officially launched in December 2013, will commit to the development and delivery of a broad range of programmes that will embrace professional standards and modern thinking that will be more applied and updated. Appropriate resources will also be committed to shape a future agenda that includes the concept of professionalising the banking profession, incorporating ethics education and a necessary suite of behavioural competencies to complement technical skills. It will be backed by multidisciplinary research playing a leading role in industry awareness through thought leadership publications and conferences.

There will be an international research centre supported by a knowledge management system that will enable archiving and easy access, allowing others to analyse, access and process information. With technological advancement, knowledge management systems will make available electronically a knowledge repository of academic and professional publications.

The curriculum design in both content acquisition and development will match international business university standards, upgraded regularly and benchmarked against the best-in-class. Indeed, content development will include inputs and case studies from people who understand the business, hence the emphasis on practical experiences and relevance. For example, Chartered Banker Qualifications will serve this purpose; aligned to the industry competency and skills framework, the intent is to ensure a more robust career road map for banking professionals. The enhanced career road map will allow either managerial or specialised routes, necessary to support a growing industry. Given the changes in the industry landscape, a broad-based qualification supported by relevant short-term courses would equip the aspiring banking professionals with the necessary development support.

CONCERN

The effect of transformation will mean greater integration of learning and knowledge management. The learning management system for example has a powerful impact that includes greater access of training departments to learning returns, and help to connect with learners and providers resulting in better decisions and planning.

Learning architectures

The development of a robust architecture to support the development and delivery of a variety of banking courses to wider geographies will be possible. To progress, the Asian Banking School will innovate on its pedagogies, including blended learning incorporating language and workplace knowledge to improve and guide performance, collaborations with reputable partners, and a host of web-based tools. For example, one of these learning support tools will empower learners to own and manage their own learning at their own pace. These learning support tools come in various forms that support learners' needs at various stages of their learning lifecycle. In order to strengthen our support to learners, the Asian Banking School will invest in a myriad of learning tools that both enrich learning experiences and enhance their performance at the same time.

E-delivery

To meet industry demands, a strategy to rethink on aligning learning applications to the changing landscape of learning technologies will be helpful. An enhanced curriculum requires an investment in IT infrastructure that supports a delivery system with fast internet access and international faculties to support the process for students to think critically and communicate clearly and embrace integrated skills. In the same spirit, e-learning through the learning management system will complement the delivery capability. For example, students can choose to do e-learning tutorials that will be designed to complement or add on to what is covered in the primary study texts of any qualification programme. It does this by specifically highlighting difficult or complex concepts that need more focus and explanation. E-learning tutorials should cover core knowledge that is considered absolutely fundamental to a learner's understanding and eventually crucial to a learner's better performance. E-learning tutorials are also important in that they cover core knowledge and/or difficult concepts that are deemed extremely important to a learner's knowledge base in a particular qualification.

The effect of transformation will mean greater integration of learning and knowledge management. The learning management system for example has a powerful impact that includes greater access of training departments to learning returns, and help to connect with learners and providers resulting in better decisions and planning. While no one disagrees on such value propositions, the challenges are the need to realign banks' training culture to feel and experience a host of tangible and intangible effects. Learning technologies will continue to evolve and disrupt the learning culture but it is important that learning managers need to socialise and maximise the benefits from such changes.

Not all training policies in banks are, however, flexible enough to empower their employees with such choices. Embracing e-learning as a mainstream delivery platform is one of those choices. Physical classrooms and facilities, however, will not disappear. Instead, they will be integrated with the blended learning concept where there are opportunities to use the right facilities and technologies in delivering courses beyond online learning.

Differentiating

The Asian Banking School will differentiate itself through the development of a diverse global footprint, supported by an extensive network of professional experience, and robust learning methodology. For

example, it will collaborate with fewer but better learning partners focusing on the appropriate learning content and technologies, and the highest professional standards will be applied. There will also be innovations in learning applications, and commitment towards greater integration between knowledge management and education in both teaching and learning. The intent is also towards cultivating the next generation of learners in the e-learning environment.

Learners' choices

To respond to industry changes, learning solutions must be broad-based. The rules have changed, and business as usual is no longer adequate. Focus is not only on access but involves positive learning experiences that allow learners empowerment, choices and a learning culture. A powerful development is the introduction of a more impactful blended learning culture and system; one that is more efficient through the integration of knowledge and application as well as bringing the learners closer to the desired learning outcomes.

The establishment of a banking school reflects such a forward-looking strategy, and one that will aim to more than adequately address the banks' challenges, and their strategy to ensure the right people with the right skills are available at the right time. To succeed, this requires a rethink and a change in the education agenda. ✱

■ Tay Kay Luan is the Chief Executive Officer of the Institute of Bankers Malaysia (IBBM).

Coexist

To regain their competitive edge, banks must quickly figure out how the new can efficiently, at least for the foreseeable future, coexist with the old.

SIMPLIFYING CUSTOMER AND BANKING EXPERIENCE

REAL-TIME PROCESSING IS INEVITABLE FOR BANKS AS CUSTOMERS SEEK INSTANT GRATIFICATION. THE SUCCESSFUL BANK OF TOMORROW MUST SIMPLIFY THE CUSTOMER AND BANKING EXPERIENCE – AND ENABLE SELF-SERVE BANKING – IF IT IS TO THRIVE IN AN OPEN ENVIRONMENT WHERE LIBERALISATION AND INTEGRATION ARE THE NORM.

CHET KAMAT

Commercial banks today are at an important crossroads where tech-savvy customers, outdated IT infrastructure, and strong regulatory headwinds are all coming together. Personal and business customers demand that their banks rapidly adopt and integrate the latest technologies to enable anytime access to their accounts and provide the same convenience and flexibility to which they have grown accustomed from other types of vendors. IT departments are becoming more challenged to keep pace with rapid business change with their legacy systems. At the same time, regulators are working on new and ever-more complex banking regulations. For a bank to thrive in this environment, change is inevitable.

Peaceful coexistence

To regain their competitive edge, banks must quickly figure out how the new can efficiently, at least for the foreseeable future, coexist with the old. Recognise that while branches, cheques, passbooks, and other holdovers from the last two centuries may be decreasing in volumes, they will still be around for the foreseeable future and coveted by some of the bank's most profitable customers. Today's banks are becoming more challenged to service traditional banking products and comply with new regulations while providing innovative and compelling new offerings to attract and retain customers.

Technology is another challenge. As IT departments continue to retrofit ancient COBOL/Assembler applications to support the latest Java-based technologies and comply with new industry regulations, they are creating overly complex solutions that are becoming more brittle, harder to support and more susceptible to failure. These integration challenges further prolong the time-to-market for implementing new products as

INEVITABLE

THIS TRANSACTION UBIQUITY and process centricity have the ability to drive innovation in banking services in branches; we may see iPads and other mobile devices in tomorrow's branches instead of the traditional design of today. The inevitable move towards real-time processing must and will simplify the customer and bank experience.

well as accommodating basic system changes. It is no surprise that up to 80% of some bank's IT budgets cover basic support activities, and new product implementations can take over a year.

Inhibitors to change

Most large banks still rely on batch processing architecture to post transactions to customer accounts and leverage a memo post file to ensure accurate customer cash positions throughout the day. Though this architecture has proved surprisingly resilient for the last half century, today's customers expect immediate confirmation of their transactions, accurate and real-time cash positions, and consistency across channels. All of these can best be accomplished by phasing in real-time transaction processing.

To thrive in this new environment, banks must be able to simplify their processing infrastructure while allowing customers to self-select their service offerings. Customers expect the flexibility to transact when and how they want as they have become accustomed to instant gratification for everything from downloading music to buying books.

The successful bank of tomorrow must find a way to allow its customers to self-serve across all channels while minimising the need for assisted channel support from branches or customer care centres. This transaction ubiquity and process centricity have the ability to drive innovation in banking services in branches; we may see iPads and other mobile devices in tomorrow's branches instead of the traditional design of today. The inevitable move towards real-time processing must and will simplify the customer and bank experience. ✱

TRANSFORMATION WILL BE KEY

Banks can no longer defer decisions on modernising their infrastructure; they need to adopt scalable, modern platforms that can enable the following:

- **Better customer views, including complete party-to-party relationships to enable meaningful relationship pricing;**
- **Capabilities to rapidly launch innovative, new products to drive new revenue streams;**
- **Support for both traditional and emerging financial services products to retain existing, profitable customers while attracting new, potentially profitable ones;**
- **Process centricity to drive consistent service quality across all channels;**
- **An efficient regulatory compliance framework to redirect IT resources towards competitive enabling initiatives.**

■ Chet Kamat is CEO and Managing Director of Oracle Financial Services Software Limited. He brings more than 25 years of financial services, consulting and business transformation experience to this role. Prior to joining Oracle, Chet was Managing Director at STG and responsible for the transformation and operations of its portfolio companies with a specific focus on their use of global operating models. Earlier Chet worked as the CEO of a retail financial services startup and at Accenture. Chet has also served as the Chairman of the Board of Directors at Teleca AB, and as a Director on the Boards of Netik Inc., Symphony Marketing Solutions Inc. and The Capital Markets Company NV.

HOW TO SUCCEED IN CORPORATE BANKING

AS MORE ORGANISATIONS PURSUE A REGIONALISATION STRATEGY AMIDST A LIBERALISING ENVIRONMENT, IT BECOMES IMPERATIVE FOR BANKS TO TAILOR SERVICES TO FIT THEIR CUSTOMERS IN ORDER TO BECOME OR REMAIN CORE BANKS OF CHOICE. SUCCESS FOR CORE BANKS LIES IN FOCUSING ON CORE AREAS OF PROFITABILITY, ACCORDING TO A RECENT **EY** REPORT, ***'SUCCESSFUL CORPORATE BANKING: FOCUS ON FUNDAMENTALS.'***

CHOW SANG HOE

As corporations expand their markets globally, the demand for their core banks' services will increase in tandem. A bank's aim is to sustain profitability while providing their customers with the required services. As such, banks serving corporate customers will be required to continually develop new solutions, ensuring that they maintain their customer base, and that they don't lose their revenue source from these customers to competitors.

There are four main areas that banks can focus on to achieve their profitability and at the same time provide their corporate customers with exceptional service.

It's about relationships

A relationship between a bank and a customer is established when the bank provides the customer with services suited to their needs. It is this relationship that determines if a bank eventually becomes the customer's core bank.

In a study conducted by EY last year, senior executives from 20 global corporations described core banks as banks that commit the most time and money to the relationship. Seventy per cent of the participants interviewed indicated that they used more than five banks (Exhibit 1).

Corporate financial executives will tend to find it a struggle to maintain a strong working relationship with a bank. The higher

cost of credit has also resulted in many corporate financial executives assessing the cost versus the benefits of each service used. Executives evaluate whether to continue an existing relationship based on a variety of matrices, such as availability, professionalism, customised service offerings, turnaround time, industry and business knowledge, as well as service efficiency.

Hence, banks looking to retain their corporate customer base have to ensure that relationships with customers are reviewed periodically. This provides banks with insights into their customers' needs and opportunities to cross-sell.

Two major factors will likely influence the service needs of corporate customers. The first is the higher cost of working with banks, potentially due to Basel III. This will prompt corporations to look for alternative funding. The second factor is corporations' expansion plans into new markets and regions. This will have an impact on the types of services and products banks need to provide.

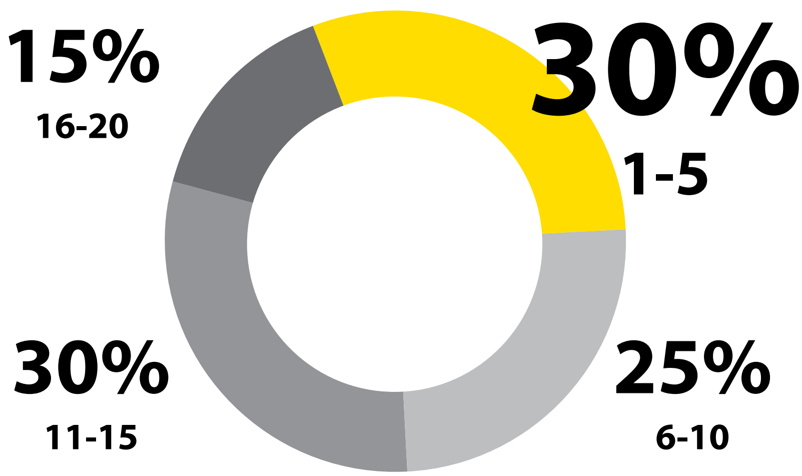


Exhibit 1: Number of core banks
(Source: Successful Corporate Banking: Focus On Fundamentals, Ernst & Young 2013)

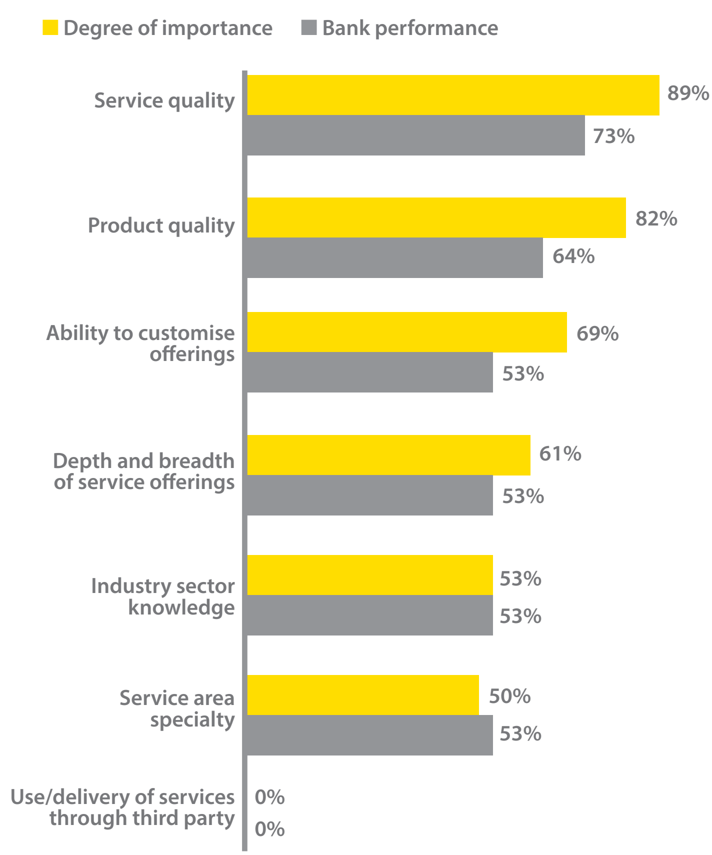


Exhibit 2: Top performance criteria for services and products
(Source: Successful Corporate Banking: Focus On Fundamentals, Ernst & Young 2013)

Criteria

Our study indicates that the ability to customise offerings, the depth and breadth of service offerings, industry sector knowledge and service area specialty are among the key performance criteria in selecting and keeping a core bank.

Adding value

Corporations evaluate and choose banks based on the existing relationship, credit commitments, products and services offered, as well as pricing. The EY study indicates that the ability to customise offerings, the depth and breadth of service offerings, industry sector knowledge and service area specialty are among the key performance criteria in selecting and keeping a core bank (Exhibit 2).

Customers also tend to look to their primary group of banks as their 'thinking partners' who can assist them in identifying their pain points, and to develop solutions based on their needs. The interviewees noted that the two top benefits in working with core banks are the advisory services and innovative ideas that the banks can provide. Developed by the bank together with their customers, these ideas will aid in developing products and solutions fully tailored to specific needs.

Another key point is that banks should find the right balance between service and sales. For example, banks should not threaten to retract their services when the customer does not accept their sales offer further. Opinions vary on whether value-added advice should be an extra charge or bundled as part of other services. Most of the participants believe that advice offered should be bundled as part of an existing service received. However, a few respondents said they were willing to pay for services that are specifically tailored for the corporation. These services should be exclusive to the customer, catering to specific business needs. Several executives have also noted that working with third parties has often been challenging, and they prefer their banks to deliver these services directly.

Consistency in performance globally

As corporations expand in multiple geographies, so will their relationship with the core banks in these regions. In terms of market coverage, both overall geographic footprint and the presence of the banks in key growth markets were rated as very important by most executives (Exhibit 3). Several participants noted that the importance of geographic capability varies by service area. As an example, cash management mostly requires a worldwide footprint, but this may not be necessary for other services.

Another challenge strongly highlighted by the interviewees is inconsistent pricing across the globe. Global pricing models should be discussed between banks and customers. As one executive explained, "We are an international company, and we consider our bank to be a global relationship partner. We want the same fee structure in Asia, the US and Europe." Banks should implement changes to fees and charging structures as customers operating in multiple geographies will require consistent service across the regions. Easing their operations reduces the hassle of having to fit their operations to meet specific requirements.

Technology enablement and differentiator

Technology is a vital requirement in supporting customisable services and products. Therefore, banks' technological platforms must be advanced enough to support the requirements of these features.

The lack of sophisticated technology is a major disappointment to finance executives. A large number of new regulations have stressed the importance of banks' data and reporting platforms. Banks will be required to make significant enhancements to their technology and data infrastructure by as early as 2016, as per Basel III. The importance of cybersecurity also sees the need for updated systems and advanced data storage capabilities.

Few banks have adopted an enterprise-wide approach to cater to the increasing needs of business and regulatory requirements. Most have opted to invest in an incremental enhancement approach instead. The enterprise-wide approach is a costlier solution compared to the incremental enhancement approach. Banks should also consider standardising systems across multiple locations as this saves cost in the long run and allows banks to integrate analytics, as well as provide a better solution to clients operating globally. The integration of core systems will also ensure a standardised customer experience. However, the integration of core data will increase the risk in terms of cybersecurity. An aspect worth considering is to ensure the system is able to zerorise confidential data, in the case of hacking or virus attacks.

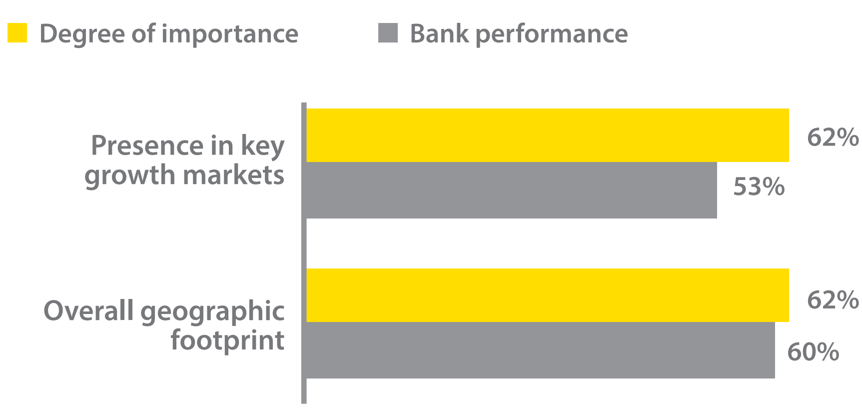


Exhibit 3: Top performance criteria to market coverage *(Source: Successful Corporate Banking: Focus On Fundamentals, Ernst & Young 2013)*

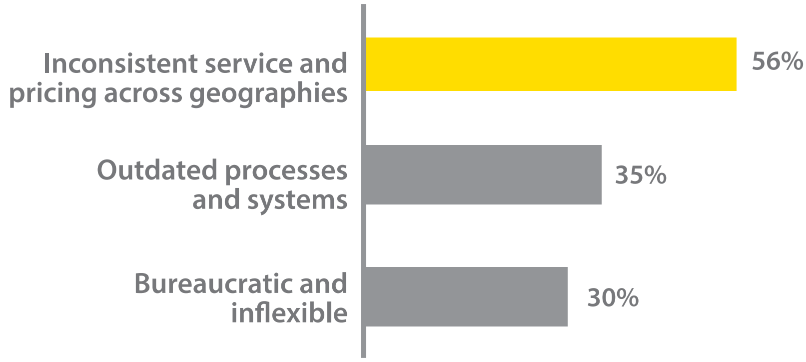


Exhibit 4: Top challenges dealing with banks *(Source: Successful Corporate Banking: Focus On Fundamentals, Ernst & Young 2013)*

"I had a situation three or four years ago where a primary bank was continually submitting non-competitive bids. I had to have a tough conversation with them, and they ultimately left our core group."

WHAT WOULD MAKE YOU CHANGE BANKS?

■ "The cost would drive me to change. If they are not cost-competitive compared to the others, they would be out. All of our primary banks should have the same risk appetite, and this should be reflected in comparable pricing."

■ "When I need a bank, I need a bank. When we do a strategic initiative, I expect my primary bank to be with me. If they are not, I will reconsider the relationship."

■ "It depends on the magnitude of the problem. If it's consistent under-performance, I'll terminate them. If it's a disagreement, then we will have a conversation. I will closely monitor performance and then make a decision."

■ "We would change if the bank were to be downgraded to a low rating — our Audit Committee would challenge us."

■ "I recently fired a bank for being relentlessly too pushy."

■ "I always tell banks I'm not the person you need to make happy. You need to make my team happy. I'm not going to work with a bank because I like the person. It's really bottom-up. If you make my team's life miserable, I will make you miserable until you make them happy or we call it quits."

■ "I prefer to settle a dispute if at all possible rather than issue RFPs (request for proposals), which are too much work."

Source: Successful Corporate Banking: Focus On Fundamentals, Ernst & Young 2013

"Keep an ongoing dialogue with your clients. Be open to suggestions. Don't worry about how it fits in the box that exists – draw new lines and create a new box."

LISTEN TO YOUR CUSTOMERS

We asked interviewees to offer one or two recommendations for how banks can improve services and products to better meet needs and expectations. Here's what they said:

■ "Banks need to understand the priorities and the business scenarios that their clients are trying to solve — try to look at it from our point of view."

■ "Frankly, for me, they need to better understand their clients and their clients' needs. Very few banks spend time understanding their clients in reasonable detail."

■ "Be more in tune with what your client is saying. Banks need to anticipate your next move."

■ "Always listen to your client. Don't try to impose things that are not relevant. We like ideas as long as they are relevant."

■ "We need them to show up and understand us and provide ideas and matches of their products to our needs."

■ "Know us and our culture better, figure out who we are and what we are interested in and what we are not interested in. Know us so that when you come and pitch something and right when you open the book, I don't just roll my eyes and think, 'This doesn't make sense and you are wasting my time.' Come to us with fewer ideas, but better ideas."

Source: Successful Corporate Banking: Focus On Fundamentals, Ernst & Young 2013

	Degree of importance		Bank performance	
Service quality	**89%**	rate service quality as the top criterion.	**73%**	say banks are performing well; however 56% cite lack of consistency in the delivery and quality of services across geographies as a top challenge.
Product quality	**82%**	list product quality as very important.	**64%**	give their banks strong marks, but they note that good product offerings are a prerequisite to even being considered as a core bank.
Stability	**76%**	say financial stability and performance of banks are critical in today's volatile environment.	**43%**	are completely confident their banks are stable and fit securely within their company's risk parameters.
Transparency	**69%**	indicate that their bank's position and transparency on risk, liquidity and capital, and portfolio concentration are important.	**27%**	say their banks are willing to share this information.
Price competitiveness	**69%**	rate price competitiveness as a top criterion.	**60%**	say they are satisfied with their bank's fees, though the majority complain of inconsistent pricing across geographies.
Customised offerings	**68%**	indicate that ability and willingness to offer customised services and products is an important relationship criterion.	**53%**	say their banks are doing a good job in this area.
Technology sophistication	**65%**	say that technology sophistication is important.	**55%**	give their banks good marks but over a third (35%) cite outdated processes and systems as a top challenge in working with banks.
Innovation	**63%**	list innovation in services and products as key.	**40%**	rate banks as performing well.

Corporate finance executives were asked to rate on a 1-10 scale (where 10 equals most important and 1 equals not at all important) the degree of importance of 16 performance criteria in the selection of their core banking team. They were then asked to rate on a 1-10 scale (where 10 equals excellent and 1 equals poor) the performance of their primary bank across each of these criteria. The percentages above represent the percentage of ratings eight or higher on selection and on performance.

Exhibit 5: Overview: Bank performance against corporate criteria for selecting and keeping their primary group of banks
(Source: Successful Corporate Banking: Focus On Fundamentals, Ernst & Young 2013)

Conclusion

In order to provide better service to corporate customers, banks need to

- Ensure that relationships with their customers are revised periodically.
- Provide value-added services based on the customer's requirements.
- Provide consistent pricing globally for seamless movement of operations between countries.
- Invest in data and technology upgrades.

By focusing on fundamentals and striving to meet their customers' needs, banks can ensure that they become the customer's core bank of choice, regardless of location. ✱

■ Chow Sang Hoe is the Managing Partner for Advisory Services in EY Malaysia. He also leads the Advisory Performance Improvement practice in ASEAN. He has worked with leading financial institutions across the Asia Pacific region.

By focusing on fundamentals and striving to meet their customers' needs, banks can ensure that they become the customer's core bank of choice, regardless of location.

Profits

One option to keep the business going at the growth stage would be to use retained profits or a combination of debt and retained profits.

Grow *your* business

SUSTAINABLE FINANCING IS IMPERATIVE IF SMALL AND MEDIUM ENTERPRISES ARE TO VENTURE ABROAD AND SUCCEED AS MARKETS BECOME MORE BORDERLESS AND INTEGRATED. **'GROW YOUR BUSINESS'**, A PUBLICATION BY THE INSTITUTE OF BANKERS MALAYSIA (IBBM) IS A USEFUL AND TIMELY GUIDE ON HOW SMEs CAN SECURE FINANCING IN ORDER TO EXPAND THEIR BUSINESS AND TAP INTO THE INTEGRATED ASEAN MARKET POST-2015.

CELIA ALPHONSUS

In Malaysia, self-raised funds or bootstrapping appear to be the most significant way small and medium enterprises (SMEs) raise money to start or grow their businesses. However, the availability of bank loans and financing for SMEs in the country is growing and more and more SMEs are gaining access to loans and financing. It is imperative that SMEs learn how to leverage bank financing in order to grow their business, which in turn will stimulate growth in this key segment of the banking sector.

According to 'Grow Your Business', a publication by the Institute of Bankers Malaysia (IBBM), only 15% of SMEs got their loans and financing from banks while a mere 1.72% obtained financing from a Development Financial Institution. A whopping 55.9% of all SMEs in the country raised their financing from retained profits, internally generated funds and through the shareholders' own contributions as well as the personal savings of business owners. Obviously, there is ample room to increase these numbers by raising awareness among SMEs.

SME stages of growth determine funding choices

Financing choices also depend on the size of the SME as well as its current stage of growth. Identifying the category of SME an enterprise falls into makes it much easier to find the right loan, financing facility or government support to expand your business.

In Malaysia, SMEs are defined as micro, small and medium. Two criteria determine the differences between each category; the total annual sales turnover and the number of full-time employees.

Generally, financing is either used to acquire assets or to increase working capital and for trade financing as well as trade services. As mentioned earlier, the type of loan and financing needed would also depend on the SME's current stage of growth.

For example, a start-up would be funded and financed internally by the founders and the owners themselves. The business is looking to grow its customer base and to try and establish market presence. SMEs at this stage can benefit from relevant government grants, bank loans and financing. Micro enterprises in particular may be eligible for microfinancing. Bodies like Amanah Ikhtiar Malaysia, and Skim Pembiayaan Mikro which is a national initiative, make it easy for microenterprises with viable businesses to obtain microfinancing up to RM50,000 for working capital or capital expenditure without the need for collateral.

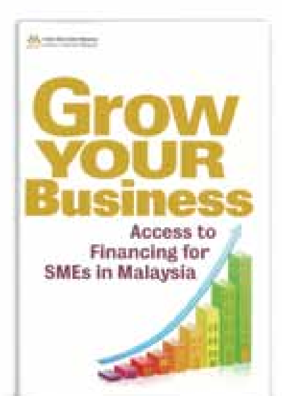
When an SME is at the growth stage, its customer base has increased and expanded and it is taking on more employees. Business is settling in and the SME is experiencing regular income flow. 'Grow your Business' says that at this point more growth has to be balanced with more income. The SME may need to acquire new assets using term loans and leasing facilities. Or if the SME is looking to hire more employees, working capital financing could help tide it over. However, the book cautions that SMEs need to monitor leverage and gearing levels as well as their debt service ratio to see if there are sufficient assets and income flowing in to cover more debt.

One option to keep the business going at the growth stage would be to use retained profits or a combination of debt and retained profits. SME owners are encouraged to check with SME Corporation for the latest information on government grants, loans or financing.

Once an SME is at the expansion stage where you already have an established customer base and a significant market presence, it may want to move on to new markets and add new products and services to its line. Capital injection can come in the form of loans and financing from banks or other institutions or the SME may decide to reach out to new investors and partners to form joint ventures and mergers.

SMEs at the maturity stage usually face quite a challenge to sustain the business. They have to keep innovating and staying ahead of the market or they risk moving backwards, losing customers and not being able to attract new customers. Such SMEs may want to look for new opportunities cross-border and to take business abroad by working with partners in different countries. They will require capital to keep going and could turn to retained profits to fund the expansion or bank loans and financing. Merging with another company or companies could also be an option. If they decide to export to other countries, then trade financing will be required.

Once an SME is well-established and mature with large and diverse customer bases in different markets, they could consider going public through an initial public offering (IPO) or selling equity stakes to another private owner.



The Islamic option

If an SME is considering debt financing as a means to propel the business forward, they should be aware that many Malaysian banks offer Islamic financing products as well as conventional products. The Islamic banking method of funding is through buying and selling of assets and charges are derived from the profit of goods sold. Conventional banking, however, funds through the lending of a specific loan amount and charges are derived from the interest based on the loan amount.

Islamic financing facilities are not referred to as loans because Islamic banks cannot lend money and earn interest on the loan they give to your company. What they can do is to earn their income from trading or buying and selling assets, and engaging in profit and loss sharing. You can request the bank officer to compare the conventional and Islamic products side by side to help you make a better choice. Do take the time to understand the different parts that make up a loan and your responsibilities and rights as a borrower. 'Grow Your Business' describes in detail the criteria for borrowers to consider when taking out a loan or financing. For example, some banks charge more for wanting to settle a loan or financing early before the agreed upon tenure is up.

You can request the bank officer to compare the conventional and Islamic products side by side to help you make a better choice. Do take the time to understand the different parts that make up a loan and your responsibilities and rights as a borrower.

While all commercial banks in the country are regulated by Bank Negara Malaysia, not all these banks provide loans or Islamic financing for SMEs. Apart from the banks, government-linked financial institutions or DFIs (Development Financial Institutions) that provide both conventional and Islamic products normally provide loans and financing for SMEs at the seed and start-up stage.

Apart from that there are 600 credit cooperatives in the country that provide credit or loans and financing. However, they only lend out money to members.

Worth a mention is the Credit Guarantee Corporation (CGC), which plays the role of guarantor. While the CGC does not directly offer loans or financing facilities, it provides SMEs with guarantee coverage. CGC assists in getting a loan or financing from a bank and sells guarantees that banks recognise as collateral for loans and financing. Companies with a guarantee from CGC have a better chance of being offered a loan or financing by a bank. But, it comes with a price.

The equity option

SMEs also have the option of pursuing funds through private equity and venture capital (equity financing). This method may involve ceding some control, as private equity investors and venture capitalists (VCs) will be entitled to part-ownership of the SME and a share of the profits. They could also be involved in the decision-making and running of the business.

There are various types of equity financing, with business angels or angel investors among the popular methods. These are wealthy individuals who invest in high-growth businesses in return for part ownership. They are often experienced entrepreneurs and business people themselves. They bring more than just money to the table as the entrepreneur will be learning from the business angel's experiences and skills.

Another equity financing option would be to woo venture capitalists. These are a type of private equity capital provided to early-stage, high-potential, high-risk and high-growth companies. VCs look to invest larger sums of money than business angels. VC investments are usually destined for sale or flotation on the stock market via an IPO. These VC investments can be provided by individuals or investment firms.

EQUITY

SMEs can also try to raise equity financing through the stock market, but they typically have very limited access to the stock market by virtue of their small sizes. Another alternative is to approach private equity groups, which normally invest in assets or companies that are not publicly owned.

With the help of technology, there has also been keen interest in equity financing through crowd funding. Also known as crowd financing or crowd-sourced capital, this is conducted online via the internet where a number of investors contribute smaller amounts of money into a business to reach the intended funding target.

SMEs can also try to raise equity financing through the stock market, but they typically have very limited access to the stock market by virtue of their small sizes. Another alternative is to approach private equity groups, which normally invest in assets or companies that are not publicly owned. Investments are made directly into private companies. Of course, such investors have also been known to buy out public companies, taking them private, resulting in their delisting from the stock market.

Ultimately, when deciding on how to optimise financing to grow an SME, bear in mind that the highest risk of debt financing would be to run the risk of non-repayment or defaulting on the loan leading to bankruptcy or insolvency. If opting for equity financing, the highest risk your SME faces would be surrendering too much or all of the ownership and control of the company. ✱

'Grow Your Business' is a publication by the Institute of Bankers Malaysia (IBBM). The book is part of IBBM's ongoing strategy and corporate social responsibility to upskill talent and enterprise in the region through innovative learning. Request for copies should be directed to ***publish@ibbm.org.my*** *or call 03-2093 8803 ext 121.*

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BENEFITS OF A STANDARD FRAMEWORK *for stress testing*

HELEN LIM

AS ASEAN EVOLVES, IT IS LIKELY THAT REGULATORY REQUIREMENTS FOR STRESS TESTING WILL BECOME MORE COMPREHENSIVE AS THE REGION STRIVES TO DEVELOP ITS FINANCIAL SECTOR. BANKS THAT INTEGRATE A STANDARD FRAMEWORK FOR STRESS TESTS INTO ENTERPRISE-WIDE RISK MANAGEMENT SYSTEMS WILL REAP BENEFITS AND BE THE BEST PREPARED TO COMPLY WITH REGULATORY REQUIREMENTS.

The need and usefulness of stress tests has been identified by regulators globally, and through efforts to meet Basel II and Basel III requirements, most banks have recognised this as well. Further, banks anticipate an increase in regulatory stress testing to determine standards for regulatory capital and the health of the financial services industry.

Stress testing is a collective term that describes techniques that can be used to estimate a portfolio's potential losses when subjected to exceptional or extreme events. To perform stress testing, shocks are applied to risk factors, such as interest rates or foreign exchange rates that, in turn, drive the value or cash flows of instruments in the portfolio. In this way, portfolio performance can be examined assuming extreme movements in the underlying risk factors. Ideally, this information is used by decision-makers to either hedge or diversify a portfolio so that an extreme event will not wipe it out.

Successfully executing an enterprise stress testing programme requires a technology framework that enables data, scenarios, analytics and reports to be integrated across the organisation. Stress testing platforms should be flexible enough to enable lines of business, trading desks and corporate risk management groups to generate multifactor stress tests and store the information for later use.

Benefits of a standard framework for stress testing.

With an increased commitment to stress testing, there is a need to improve flexibility and efficiency around the process. A standard framework would provide many benefits.

Building this flexible stress testing capability within the financial institution would dramatically reduce the manual rework costs involved in creating timely stress tests. Banks and regulators would receive the benefits gained from best practices and from access to shared research, expertise and learning.

Regulators around the world continue to emphasise that firm-wide stress testing will be a major element of risk management for financial services. In the US, the first round of government-mandated stress tests provided useful capital adequacy insights, but was limited to approximating the capital buffer needed by the 19 largest US banks under highly generalised scenarios. Likewise, the recent stress tests in Europe were conducted using a set of equally generalised scenarios and simplifying assumptions.

Timely

Building this flexible stress testing capability within the financial institution would dramatically reduce the manual rework costs involved in creating timely stress tests.

In the future, government-mandated requirements for stress testing will become more comprehensive. In the US, the Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law in July 2010, requires the Federal Reserve to ensure that large and mid-sized financial institutions perform annual or semi-annual stress testing. The act reinforces the need for comprehensive and transparent risk analysis across the firm. Regulators will specify processes and methodologies for financial institutions to assess capital adequacy under baseline, adverse and severely adverse scenarios.

Similarly, regulators in the EU will be implementing new stress testing procedures that will be required of most financial institutions in that region. These stress tests will be more comprehensive in nature than in the past and will be required on an annual basis at a minimum.

Banks will need to respond to the stress tests quickly while clarifying relevant risk factors and guidelines. Both the US SCAP (Supervisory Capital Assessment Programme) and EU stress tests provided an unprecedented view of bank assets, but required weeks of manual position aggregation on spreadsheets. Given the short timeframe, neither of these stress testing initiatives addressed the creation of repeatable processes or persistent infrastructure. Moreover, consistency of test results was not guaranteed, as multiple versions of disparate data, valuation methods and stress testing models persisted within and across institutions.

How can these challenges be mitigated? Banks might want to consider standard frameworks for stress testing which are designed to speed the process of stress testing, while also being flexible enough to address future regulatory requirements. Such standard frameworks can enable firms to streamline the firm-wide stress testing process by facilitating the integration of data and analytics into one stress testing environment. We have found from previous engagements that stress testing frameworks can help customers realise up to a 50% reduction in stress testing costs while improving system performance dramatically.

By using standard frameworks for stress testing, many groups within an organisation – including IT, risk management and lines of business – can realise significant benefits. ✱

Performances	• Efficient aggregation of results of all major risks models across the organisation. • Ability to run complex, forward-looking stress test with multiple parameters.
Transparency	• Transparent models assumption design and structure that are readily apparent to management and regulators. • Elimination of the black box characteristic of some models.
Efficiency	• Integration of existing risk models and data hierarchies. • Streamlined data infrastructure for firm-wide stress testing.
Compliance	• Capability to address major regulatory stress testing issues as they evolve. • Integration into the risk decision-making process.
Client – Specific	• Views of economic capital and pro forma financials at the enterprise level with a view of market credit and liquidity risk.

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The way forward

EUROPEAN PAYMENTS FOR ASIAN BANKERS

ASIAN BANKS PURSUING FURTHER REGIONALISATION AND GLOBAL TRADE CAN ACHIEVE GREAT STRATEGIC BENEFITS FROM COMPLIANCE WITH SINGLE EURO PAYMENTS AREA (SEPA) REGULATIONS BY RATIONALISING PAYMENTS PRACTICES, ENHANCING PROCESSES AND REDUCING THE COST OF PAYMENTS AND BANKING FEES.

IAN GOLDSMITH

Banking is now truly global and yet security risks for fraudulent financial activities and hacking to cull personal and private corporate information are at an all-time high. All financial institutions participating in international trade need to be aware of the proper security standards and global compliance regulations.

The increased trade between Asia and Europe is also driving payment activities between banks within these two markets.

To alleviate the security issue while increasing pan-European competition in the payment industry, the Payment Services Directive (PSD) has been introduced as law across the European Union (EU) since 1 November 2009.

In a nutshell, the PSD constitutes the legal framework basis for the Single Euro Payments Area (SEPA) that regulates payment services and payment service providers throughout the EU and European Economic Area (EEA).

SEPA is the self-regulation mechanism initiated by the banking sector of Europe represented in the European Payments Council (EPC). It defines the harmonisation of payment products, infrastructures and technical standards. In the long-term, the uniform SEPA payment instruments are expected to replace national Euro payment systems now being operated in Europe.

SEPA aims to provide for a level playing field by harmonising consumer protection and the rights and obligations for payment providers and users. SEPA is also an area where citizens, companies and other economic participants make and receive payments in Euro, whether between or within national boundaries, under the same basic conditions, rights and obligations.

Indeed, the SEPA Credit Transfers (SCTs) are already being adopted and used widely amongst the payments community in the Eurozone. Today's usage of SEPA Direct Debits (SDDs) are boosting up quickly as well as to ensure compliance with the provisions of the SDD Core scheme is ready by 1 Feb 2014 for countries in the Eurozone.

INTEGRATION

THROUGH THE SINGLE ACCOUNT integration method, SEPA enables financial services providers to make all their Euro payments out of one account, which significantly reduces the number of bank accounts and simplifies liquidity structures. Companies can even use a 'Payment On Behalf Of' model to make payments for their entire group from one single Euro account.

Subsequently, it is compulsory for all bank entities and payment service providers in non-Euro countries - including the Asian region - who wish to both make and receive payments with the Eurozone, to comply with SDD Core compliances at the latest by 31 Oct 2016.

At a basic level, some global treasurers headquartered in Asia and with operations in Europe may simply see SEPA migration as a European issue with limited relevance to them, thus leaving it up to the European operations to deal with the migration burden.

However, from a more strategic perspective, SEPA indeed offers a very unique and real opportunity for treasurers in Asia to achieve greater benefits by rationalising payments practices, enhancing processes and reducing the cost of payments and banking fees.

Through the single account integration method, SEPA enables financial services providers to make all their Euro payments out of one account, which significantly reduces the number of bank accounts and simplifies liquidity structures. Companies can even use a 'Payment On Behalf Of' model to make payments for their entire group from one single Euro account.

Asian banks need to comply with SEPA

SEPA payments (both the Credit Transfers and Direct Debits) must comply with the respective SEPA core rulebooks as published by the European Payments Council. In order to meet the requirements of SEPA, Asian bankers will need to perform a technical analysis of their systems to determine their ability to send SEPA-compliant Euro payments, as well as evaluate process improvements to streamline payments. They can then develop an implementation plan for any changes that are needed to rationalise the bank accounts and banking relationships.

Based on the common practices, on average, Asian banks will require 12-24 months to be fully adhered to the new PSD or SEPA. However, it all depends upon the current IT capability and business processes of the financial institutions, and how easy it is to amend the operating environment required to become PSD/SEPA-compliant.

In the market, there are vast technology solutions available that allow banks to rapidly add SEPA capability and compliance by a reduction factor of three times on average. This can be achieved by allowing the bank's back-end payment systems to remain untouched, and adding a secure and highly performing 'presentation' layer that understands and transforms payments to/from SEPA.

In the long-term, the uniform SEPA payment instruments are expected to replace national Euro payment systems now being operated in Europe.

If the bank itself does not have the resources to track global trends and compliance guidelines, a strategic technology partner is invaluable to provide the expertise needed to ensure the bank is both safe from a security standpoint and international trade-compliant.

An excellent example is the recent Technology Risk Management guidelines issued under the Monetary Authority of Singapore, which is taking a lead position in Asia by defining security standards for institutions that trade in Singapore. These guidelines are mandatory. For a bank to comply, financial institutions must now review, align and document management processes, implement compliant technology and ensure they have auditable oversight in place.

Banking has never been simple. To compete in the global market, every bank needs to ensure they have a compliance team (internal or outsourced) tracking and proactively working to meet national and international standards. ✱

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SEEBURGER is a global provider of business integration and secure managed file transfer (MFT) solutions.

Unified against crime

CRIME AND CORRUPTION KNOW NO BOUNDARIES. UNSURPRISINGLY, AS ASEAN BECOMES MORE UNIFIED THROUGH MECHANISMS SUCH AS THE ASEAN ECONOMIC COMMUNITY SLATED FOR 2015, THE REGION IS ADOPTING AN INTEGRATED APPROACH TO COMBATING MONEY LAUNDERING AND TERRORISM FINANCING.

DR R. BHASKARAN

According to the intergovernmental Financial Action Task Force (FATF), money laundering (ML) is a huge issue involving trillions of dollars and affecting the safety and security of the world and its citizens at large.

The FATF website noted that the 2009 study undertaken by the United Nations Office on Drugs and Crime (UNODC) - to determine the magnitude of illicit funds generated by drug trafficking and organised crimes and to what extent these funds are laundered – revealed that criminal proceeds amounted to 3.6% of global GDP, with 2.7% (or USD1.6 trillion) being laundered annually. While precise statistics are not available, given the illegal nature of these activities, it can be concluded that money laundering poses a significant threat.

A key defence in the war against ML is the financial institutions, which are the main channel of laundering. Financial institutions are at the forefront to identify/prevent transactions involving dirty/illegal money not only due to pressure exerted by governments but also to protect their reputation.

At its simplest, the three-step process of ML involves placement, which means cash is introduced into the financial system by some means, layering which involves one or more complex financial transactions to hide/camouflage the source, and integration which results in acquiring (clean) wealth generated from the transactions. Obviously, there is no hard and fast rule that the three steps must be followed in a sequence, and innovative money launderers keep improvising their methods. As a result, both ML methods and the efforts to curb them are ever evolving. It seems that evolving technology is an enabler of ML and also a tool for prevention!

Anti-money laundering

In official parlance, the term 'Anti-money laundering (AML)' denotes the sum of efforts, controls and regulations that the banks, financial institutions and other regulated bodies undertake to detect, report and prevent ML activities. The formation of the FATF and the promulgation of an international framework encompassing 49 recommendations of anti-money laundering standards have resulted in highly coordinated efforts among countries to combat the menace. The FATF monitors and coordinates country-level efforts in terms of their legal systems, official machinery in position for combating money laundering/financial terrorism (ML/FT) and cooperation that a country extends to agencies/other countries in anti-money laundering/combating the financing of terrorism (AML/CFT).

Banks play a crucial role in AML/CFT. But banks alone cannot combat money laundering. An effective AML effort requires legal provisions which make money laundering a criminal offence and well-empowered regulatory and police machinery to follow up cases and penalise ML. It is also necessary to share information and cooperate with other countries. Furthermore, financial institutions (banks, non-bank financial institutions, cooperatives, microfinance institutions (MFIs), insurance companies, post offices, etc.) should ensure that they identify their customers, have a customer acceptance policy which ingrains the AML principles, have rigorous risk-based controls, keep records, and report suspicious transactions. On their part, government and regulators should take quick action on these suspicious transactions. Banks must collaborate with the regulators such that the AML regime is implemented effectively.

Today, in almost all countries, financial and non-financial institutions are required to identify and report customer transactions of a suspicious nature to the financial intelligence unit (FIU) in the respective country.

Banks have been specifically advised to verify their customer's identity or Know Your Customer (KYC), do customer due diligence (CDD) and monitor transactions for suspicious activity. CDD includes understanding the kinds and volume of transactions the customer is likely to engage in, such that the bank is able to identify unusual or suspicious behaviour pointing to possible ML activities. KYC will be more effective if the objective and process of CDD is shared more openly with the customers. Currently, in most countries, CDD is perceived as a routine form-filling exercise, whereby customers feel more agitated than informed.

For efficient AML, bank employees, particularly those who touch base with customers, should be familiarised with identification of ML activities and instructed to report activities that they deem suspicious. They should be trained to elicit information from the customer without losing the customer.

Given the large customer base and the rapid speed with which data is transmitted through the system, banks use 'anti-money laundering software' to filter customer data, classify it according to level of suspicion, and scrutinise the same for possible anomalies and resultant risks. The software can flag names on government 'blacklists', politically exposed persons (PEPs) and transactions that involve countries which are considered risky. Once the software has mined the data and flagged suspect transactions, banks can take appropriate action.

According to the 2011 KPMG Global Anti-Money Laundering Survey, the cost of implementing AML for the financial sector is said to grow at 45% every year and compliance is a matter of concern. Worse, in recent years, penalties levied by the regulator for non-compliance or failure of KYC or CDD or poor AML implementation have been on the increase. Understandably, the financial services industry has become more concerned about the rising costs of compliance. Meanwhile, customers suffer a sense of disenchantment; every time a new method evolves for money laundering he or she is subject to more rules and regulations.

Table 1 on Compliance to the overall 49 recommendations of FATF by the ASEAN countries (based on data from *www.know your country.com*)

Status	C	LC	PC	NC	NA	Rank[1]	% of NC
Country							
Brunei	3	16	14	16	0	V	32
Vietnam	1	3	25	18	2	VIII	37
Thailand	2	4	29	13	1	VI	26
Singapore	11	32	4	2	6	I	4
Philippines	4	11	28	6	0	III	12
Myanmar	2	2	28	15	2	VII	30
Laos	1	2	9	35	2	X	71
Cambodia	0	0	13	33	3	IX	67
Malaysia	9	24	15	1	0	II	2
Indonesia	4	8	22	14	1	IV	28
(C = Compliant. LC = Largely Compliant. PC = Partially Compliant. NC = Non-Compliant. NA = Not Applicable)							

[1] *Overall Rank among ASEAN countries derived from the ranking in Know Your Country, 7 September 2013*

Table 2: Compliance to the recommendations on Legal Systems in the case of 10 ASEAN Countries

Subject	Money Laundering Offence	Confiscation & Provisional Measures	Secrecy Laws	Customer Due Diligence	Record Keeping	New Technologies	Regulation Supervision and Monitoring
Country							
Brunei	LC	LC	LC	PC	LC	NC	PC
Vietnam	PC	PC	LC	NC	PC	NC	PC
Thailand	PC	LC	C	NC	PC	NC	PC
Singapore	PC	LC	C	LC	LC	LC	NC
Philippines	PC	PC	PC	PC	LC	PC	PC
Myanmar	PC	PC	PC	NC	PC	C	PC
Laos	PC	C	LC	NC	PC	NC	NC
Cambodia	NC	NC	PC	NC	NC	NC	NC
Malaysia	PC	LC	PC	LC	C	C	LC
Indonesia	PC	PC	LC	PC	LC	LC	PC
No of PC	8	5	4	3	4	1	6
No of NC	1	1	0	5	1	5	3

AML/CFT in ASEAN

A country's AML/CFT status can be assessed with reference to its compliance to the 49 recommendations of FATF. This includes 25 recommendations on legal systems and enabling legislation. There are nine recommendations on FIU-related issues and six on international cooperation, some of which are considered crucial.

Where does ASEAN stand in terms of AML/CFT? As the region marches towards a Prosperous and Peaceful ASEAN 2015, these countries have come under a single banner to take a comprehensive and mutual cooperative approach to AML /CFT, noted Chat Le Nguyen of the School of Law, University of Christchurch, New Zealand in the *Journal of Money Laundering Control, Vol 15 No 4 2012.* ASEAN countries have already taken steps to bring in appropriate regulations and rules. But there appear to be certain gaps in implementation.

The overall compliance of ASEAN to the 49 recommendations shows a mixed bag. It is evident that some countries have to catch up fast with the leaders in AML/CFT, namely Malaysia and Singapore (see Table 1).

An analysis of compliance to seven recommendations on the legal systems and procedures shows (see Table 2) that barring Malaysia and Singapore, the rest have to invest more effort in meeting with the recommendations. Possibly this is why FATF mentions that some of the countries need to take quick action.

FIUs are agencies that receive reports of suspicious transactions from financial institutions and other persons and entities, analyse them, and disseminate the resulting intelligence to local law enforcement agencies to combat money laundering. As government agencies, FIUs must retain sufficient independence to accomplish their objectives without undue interference or influence. The compliance of the ASEAN countries in this regard (Table 3) would show that they have created the FIUs and empowered them but face implementation issues. *The Asia Focus* periodical newsletter of November 2012 released by the Country Analysis Unit of the Federal Reserve Bank of San Francisco reports that "lack of skills, training and resources often hinder the capacity to establish and maintain FIU".

Cooperation among countries is important to combat the ML/FT threat. Globalisation has resulted in ML also originating in other countries. The ASEAN countries show a mixed level of compliance to five of the important special recommendations (see Table 4).

Table 3: Compliance of ASEAN countries to recommendations of FIU & Others

		FIU[2]		Other important recommendations	
Area or Issue	**FIU**	**Powers of Authorities**	**Criminalise Terrorist funding**	**Freeze and confiscate terrorist assets**	**Suspicious Transaction Reporting**
Country					
Brunei	NC	C	LC	NC	LC
Vietnam	PC	LC	NC	NC	NC
Thailand	NC	C	PC	PC	PC
Singapore	LC	C	LC	LC	C
Philippines	PC	PC	NC	PC	PC
Myanmar	PC	LC	NC	NC	NC
Laos	NC	LC	NC	NC	NC
Cambodia	NC	PC	NC	NC	NC
Malaysia	C	C	LC	LC	PC
Indonesia	LC	C	PC	NC	PC

(Note: PC in the case of FIU does not mean FIU does not exist. Rather, it shows that either FIU is not empowered or that it does not cover all money laundering activities as enumerated by FATF.)

2. *Chat Le Nguyen's 'Towards the Effective ASEAN Mutual Legal Assistance in Combating Money Laundering' gives a table where the ASEAN compliance regarding FIU etc. shows a better position*

Table 4: Details of compliance to the important five out of nine Special Recommendations of FATF

Subject	**Implement UN Instruments**	**Conventions**	**Mutual Legal Assistance**	**Other Cooperation**	**International Cooperation**
Country					
Brunei	LC	LC	PC	PC	NC
Vietnam	NC	PC	PC	PC	NC
Thailand	PC	PC	PC	LC	PC
Singapore	LC	LC	LC	C	LC
Philippines	NC	LC	LC	LC	PC
Myanmar	PC	PC	PC	PC	NC
Laos	NC	PC	NC	NC	NC
Cambodia	NC	NC	PC	PC	C
Malaysia	LC	LC	LC	PC	LC
Indonesia	NC	PC	PC	LC	PC

Banking Sector and AML/CFT in ASEAN

A major portion of ML happens through the financial system. Financial institutions, in particular banks, are most vulnerable to abuse for that purpose. In order to protect themselves (ML could lead to losses and reputation risk) it is essential that financial institutions have adequate systems, procedures and controls in place such that they know with whom they are dealing. Adequate due diligence on new and existing customers is a key part of these controls. ASEAN countries have enacted new legislation and framed regulations aimed at strengthening the AML/CFT, yet some of them lag implementation rigour.

Table 5: Boards and AML/CFT: Responses to KPMG Survey on Compliance issues. % of agreement

Issue	ASPAC	America & Caribbean	W. Europe	Middle East & Africa	North America	Russia etc.
High Profile Issue - Board takes active interest	50	96	55	79	58	42
Moderate Issue - Board takes some interest	43	4	42	18	39	58
Low Profile Issue	7	0	3	3	3	0
Frequency of discussing AML issue						
Weekly	5	4	14	0	0	17
Monthly	20	38	20	24	28	42
Quarterly	45	43	35	64	61	25
Annually	27	0	18	12	6	16

Most banks in ASEAN have put in place the necessary systems and procedures for KYC and customer acceptance. Banks are training their staff on KYC and use IT systems to generate the Management Information System (MIS) and Suspicious Transaction Reporting (STR). However, global banks functioning in ASEAN are reportedly ahead of the curve in compliance than the local banks. FATF reports that in some ASEAN countries where there is more government control on banks, there is a greater possibility of banks being exposed to money laundering risks. Malaysia has recently undertaken a National Money Laundering and Terrorism Financing Risk Assessment at the national level. This will give a better understanding of the scale, sources, trend and methods of money laundering and help identify the vulnerabilities in the AML/CFT system and controls. It will then be possible to direct and prioritise intervention and resources to identified risks. Essentially this will lead to a strong, robust and effective AML/CFT regime and application of the risk-based approach in implementing certain AML/CFT measures in line with international standards. This in turn will have a positive impact on ASEAN countries.

Efficient CDD and a high degree of transparency are crucial to the success of banks in AML/CFT. The basic steps of CDD measures are the appropriate identification of a customer and/or beneficial owner, the verification of the identity of the customer or beneficial owner, as well as the collection of information on the customer's purpose and nature of the business relationship. It is in the case of CDD and periodic renewal of KYC that banks have been found wanting. Long-standing customers of banks do not easily come forth with the required information. Banks try to update the KYC whenever a customer comes in for a transaction and also proactively seek KYC from customers. According to KPMG, more than 70% of respondents to its survey in the ASPAC (Asia Pacific) region indicated that client screening and the handling of filter (transactions near the threshold level) hits are very challenging.

In recent years, many heavy penalties have been levied by regulators on multinational banks and on the issues of PEP and KYC which fail to identify terrorist links. Are bank boards lax on KYC? The serious intent of boards on AML/CFT can be inferred from the interest evinced by it in board discussions. The KPMG report noted that post-crisis as of 2008, boards' attention has shifted towards other risks and more pressing matters. The respondents to the KPMG survey have indicated that boards do not spend as much time on AML/CFT as in the past (Table 5). Perhaps this is due to installation of improved systems and the availability of more trained staff with the bank.

Conclusion

A perusal of ASEAN banks' policy as borne out in the banks' websites show a clear focus towards the customer and compliance to KYC norms. Banks have well laid-out policies and the technology companies (mobile, for instance) are also adopting tight KYCs. Thus, the banking and financial system is well geared to meet the challenges of AML/KYC. Most ASEAN banking regulators have stipulated that KYC and CDD should be adhered to by banks as well as non-bank financial institutions. Finally, the focus of ASEAN countries on financial inclusion will also help in AML/CFT. ✱

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RISK MANAGEMENT CONFERENCE
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