Exclusive Interview with Ms Lee Jim Leng, Group Managing Director and Chief Executive Officer of Hong Leong Investment Bank Berhad
Next-gen Banking

BANKING INSIGHT

IDEAS FOR LEADERS | **JUNE 2022**

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Inflation:
WHY WE SHOULD ALL TAKE 'SMALL STEPS IN A DARK ROOM'

Banking's response will be a reflection of its values. Tread carefully.

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Is Your Board Thinking About Cognitive Diversity?

READY FOR WHATEVER COMES: MOVING TOWARDS CYBER RESILIENCE

WEB 3.0: SHOULD YOU CARE?

Editor's Note

Never Too Cool for School

Banking has proven its resilience; transforming from the Achilles heel of the global financial crisis into a pillar of strength that has kept the economic engine running throughout this pandemic. In less than two decades, we've proven to the world that it's possible for an entire industry to learn, unlearn, and relearn. Can we do it again?

History suggests that it is during times of great distress that mankind has come up with its greatest innovations and solutions. When faced with a seemingly insurmountable problem, we've tackled the challenge by mustering all our ingenuity in order to come out the other side bigger and better. Whether it's technological breakthroughs such as digital currencies and neobanks or evolving prudential regulations to stem systemic risk, it's taken a lot of work to get the banking system to where it is at. We must protect these hard-won strides even as we chart our path into new territories.

This issue of *Banking Insight* is dedicated to exploring alternatives that will help bankers to either bridge the gap or bring down barriers. The end game is to further elevate the industry from where it stands today.

The cover story, *Inflation: Why We Should All Take 'Small Steps in a Dark Room'* by Ms Angela SP Yap, puts forth the approach that bankers should take when talking about the proverbial issue of rising costs in a challenging new world. Focusing on the fundamentals, she forces us to reexamine the daily hype that we are bombarded with in the news, through social media, and why we should weigh in more critically, especially when our research, views, and opinions are powerful tools in setting market expectations. The tenets of responsible banking require us to check our actions so that we continue to be part of the solution in rebuilding the economy.

In *Next-gen Banking*, personalisation is the name of the game. It is our privilege to feature Ms Lee Jim Leng, CB, Group Managing Director / Chief Executive Officer of Hong Leong Investment Bank Berhad. She shares insights into her 30-year career, which reads like a veritable playbook to reinvention in this age of crypto, light-touch regulation, and sustainability.

Forewarned is forearmed, especially when it comes to the pursuit of alpha. Dr Danial Hemmings of Bangor Business School, UK, our collaborative institution in delivering the Chartered Banker MBA, predicts that special purpose acquisition companies (SPACs) will attract attention as a renewed source of opportunity in 2022. In *SPACs: All That Glitters May Not Be Gold,* he urges value investors to beware of the unguarded risks and "costs of excess exuberance" as high deal volumes of late may "give more reason to be wary than impressed".

Dr Thun Thamrongnawasawat, who holds the distinction as Professor of Practice at the Asia School of Business, discusses how discovery of the *Freedom Within the Framework* methodology can assist leaders who struggle in finding the balance between order and free will. His point of view that "freedom and control…can work hand in hand within a framework that provides structure without being suffocating" could hit the sweet spot that you've been looking for.

Banking Insight is a microcosm of what's at the top of the agenda for the industry. In this way, we strive to fairly represent the diverse views and approaches that are out there, which coincidentally is the subject of *Is Your Board Thinking About Cognitive Diversity?* on page 18.

A power-packed read for sure. We lay down the gauntlet and challenge banks to give these new ideas a spin around the ol' block. I recommend picking your top three priority areas and try putting what you've read into practice.

This is what it means to learn, unlearn, and relearn. No matter what age you're at or how much experience you have under your belt, there's always something new to learn every day.

We are never too cool for school. ✱

The Editor

Focusing on the fundamentals, she forces us to reexamine the daily hype that we are bombarded with in the news, through social media, and why we should weigh in more critically, especially when our research, views, and opinions are powerful tools in setting market expectations. The tenets of responsible banking require us to check our actions so that **WE CONTINUE TO BE PART OF THE SOLUTION IN REBUILDING THE ECONOMY.**

AICB

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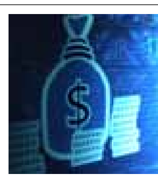

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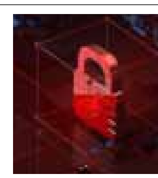

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‘Free from Financial Fragility’

This is the World Bank’s message in its *World Development Report 2022: Finance for an Equitable Recovery,* a clarion call for financial institutions to look beneath the surface and address fundamental shortcomings that get in the way of our efforts to build back better.

Carmen Reinhart, Senior Vice President and Chief Economist of the World Bank Group urges: “Prior to crises, it’s often the things that you don’t see that ultimately get you. There is reason to expect that many vulnerabilities remain hidden. It’s time to prioritise early, tailored action to support a healthy financial system that can provide the credit growth needed to fuel recovery. If we don’t, it is the most vulnerable that would be hit hardest.”

Although the share of non-performing loans remains largely unimpacted despite contraction in the economy, the organisation warns that “this may be due to forbearance policies and relaxed accounting standards that are masking significant hidden risks that will become apparent only as support policies are withdrawn”.

Its President, David Malpass, states: “The risk is that the economic crisis of inflation and higher interest rates will spread due to financial fragility. Tighter global financial conditions and shallow domestic debt markets in many developing countries are crowding out private investment and dampening the recovery. It is critical to work toward broad-based access to credit and growth-oriented capital allocation. This would enable smaller and more dynamic firms – and sectors with higher growth potential – to invest and create jobs.”

The report emphasises that the policy mix of a healthy financial sector must both free up resources for urgent investments and halt the spillover of financial risks, and highlights why improving institutional capacity to manage insolvency is mission critical:

- When households and businesses are saddled with unsustainable debts, consumption, job creation, and productive investment are suppressed.
- The longer the time needed to resolve a bankruptcy case, the larger the losses to creditors.
- Higher creditor losses reduce the availability of credit in the economy and raise its cost.
- The longer the bankruptcy process, the more time overindebted ‘zombie’ firms have to absorb resources that could support equitable economic recovery if they were redeployed to more productive firms.

WHAT IS... FINANCIAL FRAGILITY

A financial system’s susceptibility to large-scale financial crises caused by small, routine economic shocks.
~ Economists Roger Lagunoff and Stacey Schreft

Zombie Firms

While there is no universal or formal definition, it is generally agreed that zombie firms are economically unviable, manage to survive by tapping banks and capital markets, and identifiable by these quantitative benchmarks:

1. Leveraged above the sample annual median
2. Interest coverage ratio (ICR) below one
3. Negative real sales growth over the preceding three years.

The high leverage and low ICR help identify firms that cannot cover their debt-servicing costs, while negative sales growth identifies firms with low growth prospects, as sales growth is a good predictor of firms’ future performance. ~ *US Federal Reserve*

BOUNDING TO NET ZERO

This April, the *Report on the Sustainable Finance Landscape in Malaysia: An Assessment of Sustainability Practices and Product Offerings in the Financial Sector,* published by the Joint Committee on Climate Change (JC3), provides insights into the state of readiness of Malaysian financial institutions in furthering the sustainability and climate agenda.

Co-chaired by the Bank Negara Malaysia and Securities Commission Malaysia, JC3 is a platform to pursue collaborative actions for building climate resilience within the domestic financial sector. The report is follow-through from a designed survey conducted in November 2021 comprising 24 financial institutions and focuses on four key aspects of sustainability practices in order to assess the readiness of the sector:

- Sustainability commitment and strategy;
- Governance and risk management;
- Green products and solutions; and
- Climate disclosures.

The alliance concludes that "a great deal remains to be done; however, we hope that this report will provide some insights on the common issues to be addressed in the industry, and the next steps forward for the Malaysian financial sector". ✱

HIGHLIGHTS FROM THE REPORT

92% of respondents have a sustainability strategy in place

however only

42% have made commitments on net zero.

73% of banking respondents have made some commitments to ban or phase out financing of coal-related activities.

83% of respondents have a sustainability framework in their organisation

however only

46% have reflected climate risk in their risk appetite statement.

88% of respondents offer sustainability products to their customers

and

92% plan to increase the number of sustainability products in the future.

21% of respondents have a third-party verification process on their sustainability reports.

95% of respondents cited data quality or availability as one of the key challenges in driving the sustainability agenda.

BNM SETS ANOTHER GLOBAL ISLAMIC BANKING STANDARD

On 25 March 2022, the Bank Negara Malaysia (BNM) announced the introduction of the Malaysia Islamic Overnight Rate (MYOR-i) to "spur the development of innovative Shariah-compliant financial products which will further deepen Malaysia's Islamic financial market".

Developed in consultation with the Financial Markets Committee and AIBIM-FMAM Islamic Market Technical and Development Committee, the MYOR-i sets the standard as the first transaction-based Islamic benchmark rate in the world in accordance with the Principles for Financial Benchmarks developed by the International Organization of Securities Commissions.

The central bank states: "The establishment of MYOR-i as the Islamic benchmark rate will be a catalyst in driving Islamic financial product innovation and creating transparency for market players to negotiate and standardise their financial contracts, thus achieving efficient pricing across all financial instruments. This will help to deepen the onshore Islamic financial market and enhance its role in financing real economic activities in Malaysia."

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The new benchmark rate replaces the Kuala Lumpur Islamic Reference Rate and is a volume-weighted average rate of return on Shariah-compliant unsecured overnight Ringgit interbank transactions, including its Islamic overnight monetary operations.

The BNM will conduct periodic reviews of the MYOR-i "to ensure that it remains robust and representative of conditions in the underlying market".

REFRESHED CHARTERED BANKER FRAMEWORK, ENHANCED USER EXPERIENCE

In collaboration with its global partners, the AICB is proud to announce strategic developments in 2022 set to enhance the pathways to professionalisation of Asian banking talent.

First, the AICB's refreshed Chartered Banker Membership and Qualification Framework (CB Framework) introduces a new streamlined curriculum developed in collaboration with the Chartered Banker Institute, UK. This comes on the heels of an extensive review process to continuously align the AICB curriculum with the ever-evolving demands of global banking, ensuring our members are in step with international standards throughout their professional careers.

The refreshed CB Framework will commence in June 2022 with three progression levels, corresponding to a gradual phase-out of the current pathways and curricula.

Second, the new AICB Integrated Online Examination System with Pearson VUE (AICB-PV) is now live and provides members with an enhanced examination booking and learning experience. Members can now book and manage examinations via a single sign-on through the AICB Member Portal.

Further details on the CB Framework and AICB-PV are available at *www.aicb.org.my.*

RATTLING THE CAGE OF ENVIRONMENTAL CRIME

One of the five most profitable global criminal enterprises, environmental crime – the unlawful exploitation of wild fauna and flora, pollution, waste disposal, and its trade – is increasingly coming under the microscope of anti-money laundering enforcers. According to the US Financial Action Task Force, it accounts for nearly USD281 billion annually in criminal gains with associated tax revenue losses of close to USD30 billion per annum. The global watchdog's most recent July 2021 report on the subject, *Money Laundering from Environmental Crime,* comprehensively reviews the treacherous landscape, loopholes, mechanisms, and developments that all financial industry stakeholders must be aware of.

As environmental, social, and governance issues continue to gain momentum, banks should expect greater push on the enforcement front. This includes initiatives such as Finance for Biodiversity, whose latest paper this January, *Breaking the Environmental Crimes-Finance Connection,* ups the ante by proposing a new due diligence mechanism requiring financial institutions to ensure the absence of environmental crimes in their financing value chain, a move that would put environmental crime on par with illegal activities such as conflict diamonds and slavery.

Next-gen Banking

Reporting by the Banking Insight Editorial Team

Where the game changer is you.

Hard on the heels of one of the greatest crises in history, banks have been rapidly adapting on multiple fronts – new regulations, emergent technologies, customer expectations – to remain solid, agile, and relevant. It is fitting then that this issue of *Banking Insight* taps into the knowledge bank of **MS LEE JIM LENG**, Group Managing Director and Chief Executive Officer of Hong Leong Investment Bank Berhad, whose style throughout her 30-year long career is defined by the constant pursuit of innovation in all aspects of life. Beyond technical knowledge, her spirit – an unorthodoxy coupled with pragmatism – is what the industry needs to successfully transform into next-generation banks. Here are her thoughts.

Q ***You've long been an advocate for finance to look beyond mere profit and prioritise values. In your opinion, how has the landscape for environmental, social, and governance (ESG) issues changed in the past decade and do you feel there is genuine buy-in amongst the larger banking community to the principles of sustainability?***

The landscape has definitely become more robust and organised in the attempt to address ESG issues more effectively with the imposition of well-defined targets, proper laws, policies & guidelines, well-defined taxonomy and the involvement of all stakeholders, namely the regulators, the corporates, the financiers and investors, and so forth. All these are aligning the efforts of all parties towards achieving the objective more efficiently and effectively.

There is definitely genuine buy-in as evidenced by the surge in conferences, seminars, dialogues and trainings on ESG-related matters, implementation of internal ESG-related frameworks, policies by financial institutions, increase in awareness and demands by investors for responsible investment.

The pace of embedding sustainability principles was also induced by the increasing damages to the environment caused by climate related natural disasters, overdevelopment and exploration of natural resources throughout the world in recent years. These are producing more obvious and alarming threats to the balance of the natural ecosystem, supply chain of food and clean water, air quality, which will eventually have a significant negative impact on the living conditions of planet Earth in the immediate future and for generations to come.

These are producing more obvious and alarming **THREATS TO THE BALANCE OF THE NATURAL ECOSYSTEM, SUPPLY CHAIN OF FOOD AND CLEAN WATER, AIR QUALITY**, which will eventually have a significant negative impact on the living conditions of planet Earth in the immediate future and for generations to come.

Q ***Over the past two decades, financial institutions have seen the tides turn in their favour and are perceived as safe and trusted institutions, in good part due to the hard work of banks and organisations such as the AICB with its Chartered Banker framework towards professionalisation of the industry. Should banking be patting itself on the back or is there more that needs to be done?***

Organisations like AICB have served well and will continue to play a pivotal role in ensuring the continuity of professionalisation via certification, continuous training and updates on the importance of upholding the highest code and ethics within our organisations from generation to generation. Setting the right culture and supplementing with proper training, well-crafted policies and procedures and performance measurements to monitor all staff performance and guide behaviour towards delivering the desired expectation and outcome are the foundations of a high governance institution.

Such efforts must be monitored closely over time to be able to cope with the evolvement of the industry, in terms of the products and services underpinned by the advancements in technology and changes in market requirement and demand, e.g. the new rules and regulations to govern the development and operation of fintech, digital banking, etc.

Q ***Clients demand that their omnichannel banking experience be as highly intuitive and seamless as face-to-face interactions. What must bankers do to stay ahead of the curve?***

To keep abreast with the rapid evolvement and development of

the ecosystem underpinned by the advancement in technology, which are reshaping the ways business is conducted, financing is raised, investments are performed and settlements are done.

Being innovative is a key driver to stay ahead of the curve and digitalisation is an unavoidable path to pursue to cope with the rapid changes in the market. In other words, we are moving towards an era of all things digital (digital data, digital money, etc.).

BEING INNOVATIVE IS A KEY DRIVER TO STAY AHEAD OF THE CURVE and digitalisation is an unavoidable path to pursue to cope with the rapid changes in the market. In other words, we are moving towards an era of all things digital (digital data, digital money, etc.).

Q ***The world is abuzz with talk of a fourth industrial revolution. One critical aspect is cryptocurrencies such as bitcoin and ethereum, its volatility and impact on financial stability. Centrally backed digital currencies like the digital renminbi in many ways balance the risks of cryptocurrencies. How will this shape banking's future?***

There are still many issues surrounding the development of cryptocurrencies, which include its sustainability, inherent market and security risks, confidence level of users and implications on the global effort to combat money laundering and terrorist financing. To date, regulators throughout the world are still having differing views and approaches in the monitoring of transactions in this space.

Assuming the above issues could be addressed in a satisfactory and acceptable manner, many conventional ways of banking (financing and investment) and trade settlements will be phased out. The intermediary or central roles played by bankers over the past decades will diminish. Hence, to avoid being phased out, banks may be left with no other choice but to embrace this new technology and find ways to adopt digital assets in order to embrace, enhance and upgrade their financial services, i.e. an inevitable revolution transforming banking into the next generation of efficiency and innovation.

Q ***On a more personal note, what are the greatest lessons you've learnt in your decades-long career?***

Throughout my banking career spanning more than 30 years, there have been many lessons learnt. My most memorable lessons were during the last few financial crises, which we experienced globally.

Post the Asian Financial Crisis which hit in 1997, it became clear that debts – whether country, corporate or individual – need to be controlled and monitored to avoid systemic shocks to our financial system. To create long-term sustainability and stability, we need to manage liquidity shocks to our financial systems. On a personal note, while leverage has been an important factor to enhance returns, too much leverage might cloud our judgement in executing the right decisions in our workplace and, in some instances, compromise ethical standards.

The financial crisis in 2008 further reminded us of the devastating effects of overleveraging. Easily accessible credit had created an exponential growth in mortgage lending. In turn, these mortgages were sold to investors as asset-backed securities, the so-called collateralised loan obligations or CLOs. The proliferation of such CLOs resulted in the creation of derivative structures linked to CLOs. The systemic effect was felt when the bubble burst.

Personally, the biggest lesson we learnt from these chapters is to instil discipline, ethics and governance in all that we do. We can champion what we do with great passion, but never be greedy. That is the core of sustainability. ✱

INFLATION:
WHY WE SHOULD ALL TAKE 'SMALL STEPS IN A DARK ROOM'

By Angela SP Yap

BANKING'S RESPONSE WILL BE A REFLECTION OF ITS VALUES. TREAD CAREFULLY.

It's an awfully confusing time to be an economic spectator.

On the one hand, we have alarmist pundits dominating the headlines; and on the other is what its proponents consider "common sense" which wasn't quite sexy enough to make the news.

For instance, on 5 April this year, a major global bank was the first to forecast a "minor" recession in the US come 2023, then within weeks of this, revised its own projection to an even grimmer "major recession". Within the same day, ex-Treasury Secretary Lawrence Summers chimed in his *Washington Post* op-ed that "over the past 75 years, every time inflation has exceeded 4% and unemployment has gone below 5%, the US economy has gone into a recession within two years" and that the Fed's current policy of gradual rate increase will lead to poor economic performance years into the future.

However, it's important to not take headlines at face value. What Summers actually said is that there was a one-third chance of stagflation, one-third odds of a recession, and one-third odds of rapid growth with no surge in inflation – pretty much hedging his bet to guarantee he would be right no matter what. Since then, Summers has also gone on what's been described as "an I-told-you-so inflation tour", making the media rounds to state how the Fed and current government is behind the curve in wresting inflation.

In response, economists like Dr Charles W McMillion called out such clickbait, whose curt letter to the editor in the same newspaper titled *Don't Listen to Larry Summers on Inflation* fired this salvo: "Summers still wants to affect US economic policy. But why non-banksters would still pay attention to him is a mystery."

The term 'bankster' – a portmanteau of 'banker' and 'gangster' – has come to epitomise the forces or persons in financial services who continue to profit (or be bailed out) at the expense of others in the system, especially those who played a role in the deregularisation of finance pre-global financial crisis.

The also retired Dr McMillion, a former professor and associate director at the

The term 'bankster' – a portmanteau of 'banker' and 'gangster' – has come to epitomise the forces or persons in financial services who continue to profit (or be bailed out) at the expense of others in the system, **ESPECIALLY THOSE WHO PLAYED A ROLE IN THE DEREGULARISATION OF FINANCE PRE-GLOBAL FINANCIAL CRISIS.**

INFLATION PERSISTENCE

A QUICK SUMMARY OF WHY INFLATION IS HIGH AND WHETHER IT WILL PERSIST IS A TOPIC OF ACTIVE DEBATE. HERE ARE FIVE KEY DRIVERS OF THE CURRENT INFLATION SURGE, WITH IMPLICATIONS FOR THIS DEBATE.

SUPPLY CHAIN BOTTLENECKS	The pandemic had two separate effects on global supply chains. In the early phase, lockdowns and mobility restrictions led to severe disruptions in various supply chains, causing short-term supply shortages. Many of these disruptions have eased, although the recent surge in Omicron has renewed pressure on some supply chains. In the later stage of the pandemic, however, various supply chain bottlenecks have emerged as a result of strong overall demand from the economic recovery, the sharp increase in relative demand for durable goods, and hoarding and panic buying. One measure of the state of global supply chains is how long it takes to ship goods by sea. The two biggest trade lanes carry goods from Asia to North America and from Asia to Europe. The Flexport Ocean Timeliness Indicator captures the timing for each of these routes. As of the end of February 2022, measures for both remain close to all-time highs, suggesting significant ongoing pressure that may persist for at least a few more months.
A SHIFT IN DEMAND TOWARDS GOODS AND AWAY FROM SERVICES	The pandemic brought about an initial significant shift in what consumers buy; spending on goods rose dramatically. Consequently, much of the rise in inflation in the near term reflected inflation in durable goods, while service inflation increased only moderately. Such shifts may persist only during the active phase of the pandemic, but at least part of the shift in demand toward goods and away from services may persist given how the pandemic has reshaped society. As Emi Nakamura (2022) put it in a recent interview with Noah Smith, "to the extent that people shift to a lot more work from home (and fewer people are working at all) this could make some of the changes in demand patterns quite persistent."
AGGREGATE STIMULUS AND POST-PANDEMIC RECOVERY	About USD16.9 trillion in fiscal measures was announced globally to fight the pandemic, with relatively larger support in advanced economies. A warning that the large fiscal stimulus, combined with easy monetary conditions, would lead to high and persistent inflation came from a group known as 'Team Persistent'. Observers who came to be known as 'Team Transitory' opposed this view and argued that inflationary consequences of the government stimulus would likely be temporary or mild. By the end of the year, the evidence had shifted in favour of Team Persistent across several countries. Households were running down the savings they had accumulated earlier in the pandemic (including from the stimulus and transfers), which led to a surge in aggregate demand and a stronger-than-expected economic recovery. Whether the strong aggregate demand will persist is ultimately a question of how the central bank responds.
A SHOCK TO LABOUR SUPPLY	Labour market disruptions from the pandemic continue even two years after it began. Labour supply participation remains below pre-pandemic levels in several countries. Among advanced economies, the impact has been relatively larger in the United States, where participation is about 1.5% lower than before the pandemic (about 4 million fewer workers). Will this shock persist? Views differ.
SUPPLY SHOCKS TO ENERGY AND FOOD BECAUSE OF THE RUSSIAN INVASION OF UKRAINE	The February 2022 invasion has led to rising energy and food prices, which will inevitably mean higher inflation globally. Both Russia and Ukraine are exporters of major commodities, and the disruptions from the war and sanctions have caused global prices to soar, especially for oil and natural gas. Food prices have also jumped. These effects will lead inflation to persist longer than previously expected. The impact will likely be bigger for low-income countries and emerging markets, where food and energy are a larger share of consumption (as high as 50% in Africa).

Source: Adapted from *Will Inflation Remain High?*, April 2022, Ruchir Agarwal, IMF.

Johns Hopkins University, represents the other side of the coin on the inflation debate iterating that it is the duty of prudential authorities to manage inflation expectations and not succumb to populist measures.

Put aside the personalities that have weighed in, inflation elicits strong reactions from all sides because forecasting it is far from straightforward. Based on what it deems to be the target threshold for inflation, central banks use interest rates in order to bring it in line with expectations. Raising interest rates makes borrowing more expensive and tames inflation by slowing economic growth; lowering rates does the opposite.

Here's where it gets a little tricky. Raising rates too early or too much might trigger a knee-jerk reaction in consumer demand and stifle the economy; raising rates too little too late will result in prices spiralling out of control. It all depends on where we expect inflation to be rather than where it is today, which we discuss further along in this article. This is essentially the dispute between those in Summers' camp and others like McMillion, which could be described as a 'shock-and-awe' vs 'moderate' path to curb inflation.

Here's where it gets a little tricky. Raising rates too early or too much might trigger a knee-jerk reaction in consumer demand and stifle the economy; **RAISING RATES TOO LITTLE TOO LATE WILL RESULT IN PRICES SPIRALLING OUT OF CONTROL.** It all depends on where we expect inflation to be rather than where it is today, which we discuss further along in this article.

The Federal Reserve Chair Jerome Powell has chosen to adopt a sort of middle-path by announcing moderate rate increases – two hikes of 0.25% and 0.5% in March and May respectively – whilst attempting to bring expectations in line by stating "we have both the tools we need and the resolve it will take to restore price stability" to healthy levels. Although the market expects more rate increases this year, it's heartening to know that April inflation figures in the US have already slowed slightly although still high at 8.3% from its peak of 8.5% in the month prior. It bears reminding that inflation is a lagging indicator and any policy change by the central bank will take time to see effect.

DON'T SPOOK

During such roiling times, here's what more balanced commentary may look like:

"[T]he economy is experiencing a series of imported supply shocks that are pushing up inflation and depressing demand. The exit from the pandemic is characterised by global mismatches between demand and supply – in energy and goods markets in particular – with uneven effects across sectors. As a result, past economic regularities may be a poor guide for the future," states Fabio Panetta, Member of the Executive Board of the European Central Bank at a recent February 2022 speech delivered at the European University Institute in Frankfurt.

"This makes medium-term developments extremely hard to anticipate. There are forces at play that could delay the recovery and contain underlying price pressures, and others that could lead to accelerating inflation. Policy mistakes in either direction could push the economy onto an unfavourable path.

"Faced with such uncertainty, there is a case for the central bank to accompany the recovery with a light touch, taking moderate and careful steps in adjusting policy, so as not to suffocate the as yet incomplete recovery.

"If we are to durably escape the low inflation and low growth environment that has defined the past decade, we cannot afford to waste the progress we have made so far. In the spirit of William Brainard, we should take small steps in a dark room."

Far from knowing it all, the admission that these are unprecedented times and central banks are cognisant of the sensitivities any policy change would have on markets, restores some measure of balance because it addresses one of the most critical factors that affect inflation – human expectations.

COGNITIVE COSTS

How we perceive inflation can result in it being more costly than it might have been under purely rational circumstances. Recall instances of panic-buying at supermarkets or some word through the grapevine that caused a bank run. Indulging in these first-round anxieties can cause things to spiral out of control, resulting in second or even third rounds of panic in the system. There are the potential consequences of failing to manage expectations.

In economics, the Friedman-Ball hypothesis describes this phenomenon, i.e. that high inflation creates high levels of uncertainty, which if left unaddressed, could turn out to be the trickiest and costliest to rein in.

A Brookings Institute paper, *What are Inflation Expectations? Why Do They Matter?,* by Tyler Powell and David Wessel, describes the correlation between human expectation and actual future inflation:

"Inflation expectations are simply the rate at which people – consumers, businesses, investors – expect prices to rise in the future. They matter because actual inflation depends, in part, on what we expect it to be. If everyone expects

How we perceive inflation can result in it **BEING MORE COSTLY THAN IT MIGHT HAVE BEEN UNDER PURELY RATIONAL CIRCUMSTANCES.** Recall instances of panic-buying at supermarkets or some word through the grapevine that caused a bank run. Indulging in these first-round anxieties can cause things to spiral out of control, resulting in second or even third rounds of panic in the system.

prices to rise, say, 3% over the next year, businesses will want to raise prices by (at least) 3%, and workers and their unions will want similar-sized raises. All else equal, if inflation expectations rise by one percentage point, actual inflation will tend to rise by one percentage point as well."

Here's how managing expectations is crucial in bringing inflation to an acceptable level: "Central bankers' focus on inflation expectations reflects the emphasis that academic economists, beginning in the late 1960s (including Nobel laureates Edmund Phelps and Milton Friedman), put on inflation expectations as key to the relationship that ties inflation to unemployment.

"As a result of the persistently high inflation in the 1970s and 1980s, inflation expectations became unanchored and rose with actual inflation – a phenomenon known at the time as a wage-price spiral. This cycle plays out as follows: high inflation drives up inflation expectations, causing workers to demand wage increases to make up for the expected loss of purchasing power. When workers win wage increases, businesses raise their prices to accommodate the increase in wage costs, driving up inflation. The wage-price spiral means that when inflation expectations rise it is difficult to bring down inflation, even if unemployment is high."

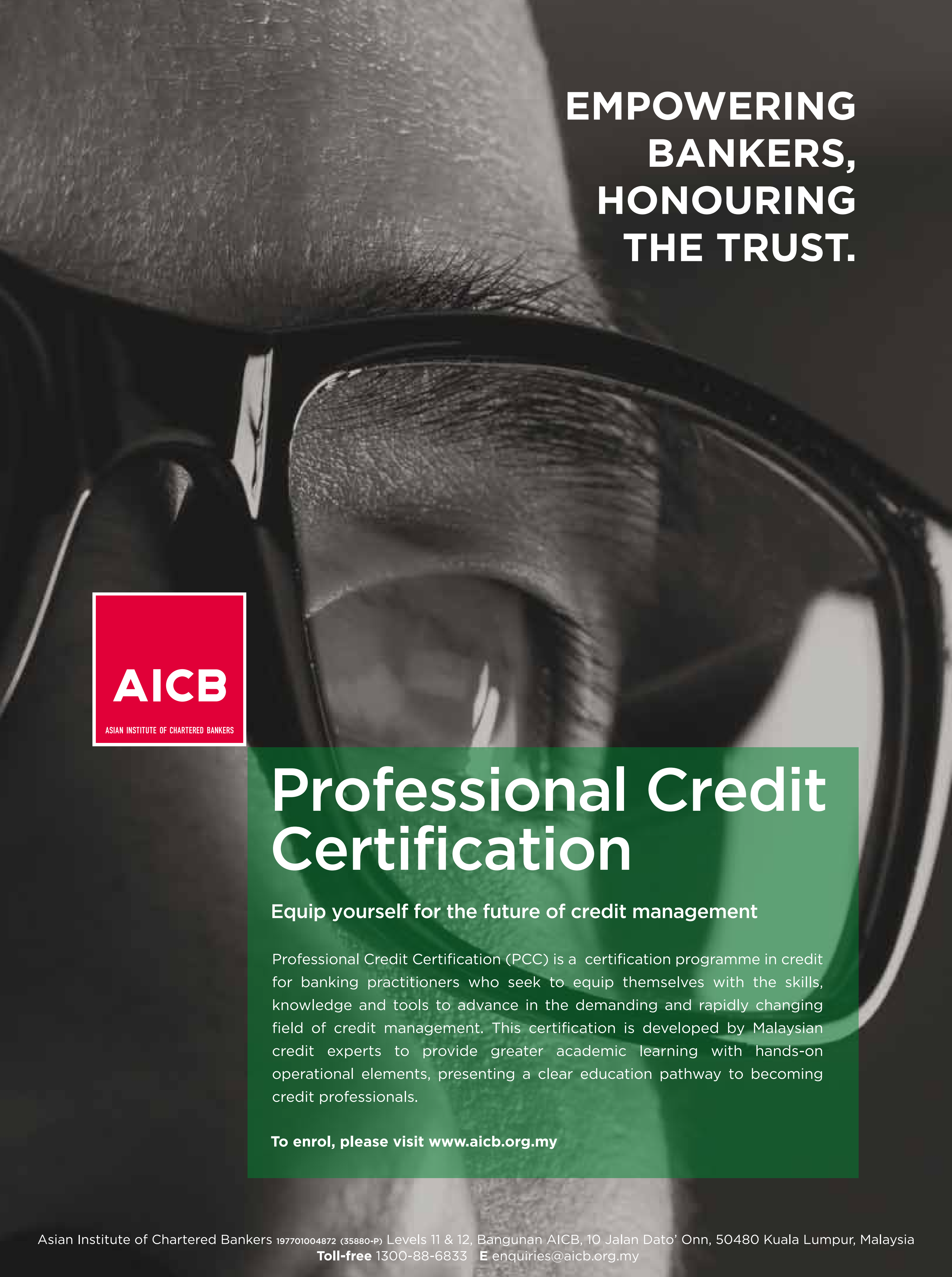
BANKER, NOT BANKSTER

Simply put, it's impossible to rein in inflation without reining in our own expectations. It's also what makes op-eds like Summers', which some might construe as an attempt to whip up populist sentiment, misleading and potentially dangerous. It spooked more than it should, for less reason than necessary. It also spurred many other research houses to posture the same, each one seemingly bent on making the first call rather than a balanced, accurate one.

In contrast, China's figures just came in at the time of writing this article, with consumer prices in March up 1.5% year-on-year, its biggest jump in three months, and prices at the factory gate up by over 8%. Yet, the chief economist for Greater China at ING in Hong Kong, has gone on record to state that for China, "inflation is not really an issue for now."

Who's right, who said it first, who beat the pack – none of it will matter if Rome is razed to the ground. After all, speaking honestly without scaremongering is what distinguishes the banker from the bankster. ✱

■ *Angela SP Yap is a multi-award-winning social entrepreneur, author, and former financial columnist. She is Director and Founder of Akasaa, a boutique content development firm present in Malaysia, Singapore, the UK, and holds a BSc (Hons) Economics.*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IS YOUR BOARD THINKING ABOUT COGNITIVE DIVERSITY?

By Julia Chong

The culture of 'think different' begins at the very top.

Mention the word 'diversity' and the first thing that comes to mind is likely gender, ethnicity, or age; but have you heard about cognitive diversity?

Many corporates and boards are actively broadening the gender, ethnicity, and age spectra of their recruits, teams, and committees. Getting more women of merit into positions of leadership, ensuring ethnically diverse representation on boards, actively recruiting from a range of experiences and backgrounds – these measures come under the ambit of demographic diversity, which is the differences in age, gender, ethnicity, and race. Yet, no matter how hotly these goals are pursued, it addresses only part of the diversity equation.

BUCK THE TREND

What's missing is an equal emphasis on cognitive diversity, described by Janine Schindler, a Forbes Councils Member and master certified coach, as "the inclusion of people who have different ways of thinking, different viewpoints, and different skill sets in a team or business group".

Her thought leadership piece, *The Benefits of Cognitive Diversity,* bemoans that there is significant resistance to diversity of thought; people and organisations tend to hold back and seek comfort in the same. "Perhaps," she explains, "they want to hire an exact replica of Ted from accounting because he was so good at his job. Or, there are managers who feel comfortable hiring people who graduated from their own alma mater. There are even those who attain a new position with a new employer and then proceed to hire their former colleagues from a previous employer, one at a time, until the old team is all back together."

"There is no doubt that people feel comfortable surrounding themselves with

"Overall, we believe that a **COGNITIVELY AND DEMOGRAPHICALLY DIVERSE BOARD IS BEST EQUIPPED TO PERFORM** its obligations and help a company compete, innovate and respond to disruption in today's challenging international markets."

others who have business styles similar to their own. Unfortunately, when you get more of the same, what you end up with is…more of the same."

Prof Katherine Klein, Vice-dean of Wharton Social Impact Initiative at Wharton Business School iterates similar views but from the perspective of quantifiable research. In her *Knowledge@ Wharton* article, *Does Gender Diversity on Boards Really Boost Company Performance?,* she bucks conventional wisdom and writes that academic research points to how gender diversity alone in the corporate boardroom isn't enough to improve corporate performance.

"If male and female board members are fairly similar in their values, experience, and knowledge, the addition of women to an all-male board may not increase the board's cognitive variety as one might expect at first blush."

She runs through the gamut of academic research which prove that gender diversity in isolation isn't as significant enough to enhance performance if it is not pursued as rigorously as other types of diversity.

What's crucial, states Prof Klein, is that corporate boards go beyond 'check box' requirements to fulfilling diversity requirements and navigate the other elemental dynamic, namely cognitive diversity. Other research also corroborate that it is the secret sauce to elevate innovation, culture, and performance of teams. We recommend reading *Teams Solve Problems Faster When They're More Cognitively Diverse* by Alison Reynolds and David Lewis, published in *Harvard Business Review,* as a quick primer to its far-reaching impact in organisations.

DIFFERENT AT THE TOP

Corporations can strive for more diverse thought by changing the tone at the top.

A thought-provoking piece by Jared Landaw, Chief Operating Officer and General Counsel at activist investment firm Barington Capital Group LP, on *Maximising the Benefits of Board Diversity: Lessons Learned from Activist Investing,* is publicly available on the Harvard Law School Forum on Corporate Governance website.

This brief but informative paper details the firm's experiences and observations as an investor in eight underperforming companies where an employee of Barington was added to the board. Interviews with directors who had served on these boards helped ascertain whether their role helped improve cognitive diversity and, if so, to what extent had cognitive diversity impacted board performance.

Landaw expounds why cognitive diversity is much needed: "We believe that public companies benefit the most by recruiting demographically diverse directors who also help improve cognitive diversity in the boardroom. As opposed to demographic diversity – which focuses on differences in people's demographic characteristics – cognitive diversity pertains to differences in people's knowledge, views, and perspectives, as well as in how they approach problems and perceive, process, and interpret information.

"As a frequent investor in underperforming companies with board composition concerns, we have found that improving cognitive diversity in the boardroom can meaningfully enhance the performance of a board. Among other things, enhancing cognitive diversity can expand a board's knowledge base, improve decision-making, and help a board more effectively mentor and monitor management.

"Overall, we believe that a cognitively and demographically diverse board is best equipped to perform its obligations and help a company compete, innovate and respond to disruption in today's challenging international markets."

Whether or not a company is currently underperforming, the Barington chief emphasises how a

DOING WITH MEANING

Approaching diversity concerns solely as a 'check box' exercise is a disservice to both the company and its shareholders. Companies eager to up their game and rise above minimum standards can take these steps as recommended by activist investor firm Barington. The end goal of such an intense exercise is not just to recruit directors who look different, but to recruit directors who bring different insights, views, and perspectives and help improve the effectiveness of the board.

#1 SELECT DEMOGRAPHICALLY DIVERSE DIRECTOR CANDIDATES WHO HAVE STRONG BUSINESS BACKGROUNDS.

More than half of the directors interviewed raised this point unprompted. As one director stated, "A director must have the business background and experience to ask intelligent questions and hold management accountable. Then if the director adds diversity of race, gender, or age to the board, it is a plus. Without such experience, it is less likely that a new director will add significant value."

#2 SELECT NEW DIRECTORS WITH PROFESSIONAL BACKGROUNDS, SKILLS, AND EXPERIENCES IN AREAS THAT ARE NEEDED ON A BOARD.

The addition of individuals who have different professional training and experiences from other directors will inevitably help improve cognitive diversity in the boardroom. It should also improve the ability of the board as a whole to meet the company's strategic and operating needs and to provide the management team with guidance on the wide variety of issues that the company will inevitably face.

To assist a board in assessing its needs, we recommend that it create a matrix identifying the backgrounds, skills, and experiences that are believed to be needed in the boardroom and the extent to which such needs are being met by the current members of the board. For internal purposes, we recommend that a board assess the ability of its members to meet each identified need on a scale of zero to five. This should provide the board with a more accurate assessment of its strengths and weaknesses than the more commonly used 'check mark' approach, which tends to imply that each identified need that receives a check mark is adequately met by the current composition of the board.

Boards can magnify the contributions that new, demographically diverse directors make by having them replace their least productive members. To determine which members of a board are no longer making a meaningful contribution in the boardroom, we recommend that boards conduct an annual assessment of the performance of each of their directors. The results of a director survey conducted by PwC in 2019 found 49% of the respondents stated that they believed that at least one director on their board should be replaced. Boards may find it beneficial to utilise an outside consultant to assist with the assessment process.

#3 IDENTIFY CANDIDATES WHO NOT ONLY IMPROVE DEMOGRAPHIC DIVERSITY IN THE BOARDROOM, BUT WHO CAN ALSO INTRODUCE NEW VIEWS AND PERSPECTIVES AND DIFFERENT APPROACHES TO PROBLEM SOLVING.

This is not necessarily an easy undertaking given that cognitive differences cannot be identified as easily as demographic differences. Thus, a careful review of a candidate's background and life experiences, as well as in-depth discussions with the candidate and the candidate's references, are inevitably required. To help a nominating committee identify demographically diverse director candidates who are cognitively diverse from others on the board, we recommend that it seek new talent pools and venture beyond using board member networks and recruitment practices that were utilised to find the board's incumbent directors. Such an approach should also help ensure that the candidates lack social and business ties to members of the board and the senior management team.

#4 EMPHASISE THE IMPORTANCE OF PARTICIPATION DURING THE ONBOARDING PROCESS.

Among other things, we suggest that new directors be told that the board not only welcomes directors sharing their thoughts and perspectives when they differ from others in the boardroom, it is counting on them to do so. In our opinion, the view that new directors should primarily be observers on a board while they learn the 'lay of the land' is outdated. We also recommend that directors be encouraged to ask questions regarding matters they do not understand or that do not seem clear to them. Often, others in the boardroom will benefit from the inquiry. While it is labour intensive, diligent director recruiting and onboarding can help ensure that demographically diverse directors selected by a board will also improve cognitive diversity and board performance.

Numbers Matter

A global *Financial Times* survey of 626 respondents who currently sit on boards reveals how directors are embracing the evolution and increasing complexity in their role and responsibilities.

72% agree that board members require a much deeper knowledge of company operations and competitors than ever before.

77% agree that boards need to make more time available to discuss opportunities for innovation and strategic growth.

45% agree that their boards have been successful in appointing members from a wide variety of professional and personal backgrounds.

40% say their boards need much greater diversity among its members (age, race, educational background, culture, experience, and gender).

40% agree that greater gender board diversity has improved the performance of their organisations.

Source: *The Great Board Reboot,* 2021.

lack of cognitive diversity at the board level institutionalises weak corporate governance which is "a serious detriment to a company and its ability to remain competitive". We provide a summary below:

- Many of these companies have a board comprised of a homogeneous group of directors. This should not be surprising, given that demographic diversity is typically poor on public company boards, particularly the boards of small-capitalised companies.
- The absence of directors with the backgrounds, skills, and experiences that are needed in a boardroom may be a concern that is not just limited to the boards of underperforming companies subject to shareholder activism. A global survey of over 2,300 directors and senior executives found that only 36% of the participants were satisfied that their boards comprised of directors who had the right combination of skills, backgrounds, experiences, and perspectives to probe management's strategic assumptions and navigate the fast-paced global environment.
- A board with weak corporate governance may be comprised of long-tenured directors or directors with business or personal ties with the CEO. It may also suffer from board pathologies such as groupthink or low-effort norms. Each of these can negatively impact board oversight and performance by decreasing the independence of members of the board and the likelihood that they will express diverse views or challenge management proposals.

PREPARE FOR THE UGLY DUCKLING

It's not an easy task. C-suites should bear in mind that the pursuit of greater cognitive diversity in the corporate world is less of a Cinderella tale and more The Ugly Duckling: at first unattractive and awkward, over time, the benefits of nurturing diverse ways of thinking and doing will eventually help organisations blossom into their full swan-like potential.

This is how we reap the full benefits of diversity in organisations. After all, demographic and cognitive diversity are but two sides of the same coin…and it takes two sides to make a full penny. ✱

■ *Julia Chong is a Singapore-based researcher with Akasaa, a boutique content development firm with presence in Malaysia, Singapore, and the UK.*

SHOULD BANKS BE THE 'CLIMATE POLICE'?

By Bob Souster

Bankers can assist in incremental transition and champion initiatives for a better world.

All over the world, large banks, and many smaller ones, have embraced strategies and policies consistent with the need to reduce the impact of climate change. There is some debate as to whether this should be an ethical obligation of organisations, or merely supererogatory, or in plain English, something they will be applauded for but are not obliged to do.

At a webcast by Bangor University on 23 February 2022, Alex Sanchez, CEO of the Florida Bankers Association in the USA, warned that bankers should not be expected to be the 'climate police'. The essence of his argument was that if governments are committed to sustainable environmental goals, they should enact legislation that will direct banks to put policies in place that are consistent with this. Ultimately, if legislators want banks to stop lending to fossil fuel companies or any other industries that desecrate the environment, it is up to them to put the necessary laws in place. Otherwise, said Sanchez, the fiduciary duty of bankers is to serve their customers as the trusted advisers that they are expected to be. He has a point.

The detrimental effects of climate change are generally accepted and there have been many supranational and national efforts to mobilise **COMMERCIAL ORGANISATIONS TO CONTRIBUTE TO THE REDUCTION OF THE POTENTIALLY DEVASTATING EFFECTS ON FUTURE GENERATIONS.**

The detrimental effects of climate change are generally accepted and there have been many supranational and national efforts to mobilise commercial organisations to contribute to the reduction of the potentially devastating effects on future generations. Few would disagree with the noble aspirations of the sustainable development goals agreed by the United Nations and ASEAN, which if achieved should ensure a better quality of life for our children, their children and subsequent generations.

Yet, there are many arguments suggesting that banks, and indeed any commercial business enterprise, should not rush into hastily formulated environmentally friendly policies. An example is the commitment of many countries to replace road vehicles driven by internal combustion engines with electric vehicles (EVs). At face value, this might appear to be a logical step, supported by visions of congested cities and towns with many thousands of cars and trucks spewing out pollution every day. However, the analysis is thin and the human costs have not been analysed thoroughly at all. EV batteries have a projected life of 10 years, which in practice suggests that the market value of a second-hand EV will plummet after about five years. In addition, there is a human cost in terms of disposal of spent batteries as well as the misery caused by child labour in many countries that mine the cobalt necessary to manufacture them.

When faced with the proposition that banks should not do business with conventional car manufacturers and shift their credit facilities in favour of those who make purportedly 'cleaner' vehicles, the jury is still out. The reality is that bankers cannot be expected to be experts on this or other complex environmental arguments. Promises that the 'technology will improve' are just that, and are not definitive. At best, many such commitments are platitudes of politicians eager to mount the environmental bandwagon.

Banks may be influenced by changes in markets. Many companies involved in 'dirty' industries have sought to divest some of their businesses associated with environmental harm. However, many such businesses are highly profitable: In a free market, where there is a seller, there will also be a buyer, so many of these assets have been taken up by private equity firms. **THE RESULT IS THAT THE 'DIRTY' INDUSTRIES DO NOT GO AWAY AT ALL**, but instead fall into the hands of new owners. They continue to operate, but under the radar of scrutiny afforded to large public companies.

Banks may be influenced by changes in markets. Many companies involved in 'dirty' industries have sought to divest some of their businesses associated with environmental harm. However, many such businesses are highly profitable: In a free market, where there is a seller, there will also be a buyer, so many of these assets have been taken up by private equity firms. The result is that the 'dirty' industries do not go away at all, but instead fall into the hands of new owners. They continue to operate, but under the radar of scrutiny afforded to large public companies.

There is also the issue of 'greenwashing', which is the practice of promoting socio-environmental credentials which do not actually exist. In an article published on 22 May 2021, *The Economist* produced evidence that the commitment of many so-called companies committed to ESG (environmental, social, governance) objectives was questionable:

> *"On average, each of them (the 20 biggest ESG funds) holds investments in 17 fossil-fuel producers. Six have invested in ExxonMobil, America's biggest oil firm. Two own stakes in Saudi Aramco, the world's biggest oil producer. One fund holds a Chinese coal-mining company. ESG investing is hardly a champion of social virtue either. The funds we looked at invest in gambling, booze and tobacco."*

We all want to do our best and contribute to creating a better world for future generations. However, this may cause many practical difficulties for bankers going about their everyday work and doing the best they can for their clients. There are many towns and villages in Malaysia and elsewhere that rely on one (or just a few) businesses that are involved in productive activities that bring harm to the environment. It is an easy decision to deny them credit for working capital or expansion on the grounds that they will harm the great-great-great grandchildren who they will never meet or know. It is harder to sell this to people who have to feed their families now. If the company closes down due to denial of the funds necessary to continue, this may deprive families of their livelihoods for the foreseeable future.

Perhaps the views of Alex Sanchez have a powerful point to make, and to some extent the difficult decisions of banks are being made for them. In the Companies Act 2006 in the UK, it is already a statutory duty of all company directors to promote the success of the company while paying due regard to the interests of stakeholders, including customers, shareholders, suppliers, the community and the environment. Enforcing this is another matter of course.

It is unreasonable to expect bankers to be the 'climate police'. Many investment decisions are not clear cut, as even the most admirable initiatives to enhance the future quality of life may be accompanied by negative externalities. Examples include hydroelectric power and nuclear energy, both of which have now been controversial for over 50 years.

On the positive side, we can all be aware of the power and ability of banks to promote good social and environmental outcomes. We can promote clean energy, eco-friendly homes, organic farming and other initiatives that will champion a better world. It does not mean that bankers have to completely abandon those in traditional enterprises that are seen by many as causing damage to mankind, but instead to help them in the incremental transition to new ways of living our lives. ✱

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ASIA PACIFIC ESG REGULATORY CALENDAR

By Moody's ESG Solutions

More information on the latest regulatory state of play across key jurisdictions for 2022 and beyond is available in Moody's ESG Solutions' quarterly Regulatory Calendar.

The information in this infographic is as of April 2022 and is an excerpt from the Regulatory Calendar document.*

+ Malaysia

Legislation: **Taxonomy**
Timing: **2H2022: Final Securities Commission Malaysia voluntary taxonomy standard**

The Securities Commission Malaysia is currently developing a voluntary principle-based taxonomy encompassing four environmental and two social objectives.

Segments Impacted: **Banks, Asset Managers, Insurers & Corporates**

Legislation: **Task Force on Climate-related Financial Disclosures (TCFD) Reporting**
Timing:

- **1 June 2022: Entry into force of new rules for banks/insurers on climate risk management**
- **31 December 2023: Banks/insurers to apply rules on governance, strategy, risk appetite/management**
- **31 December 2024: Banks/insurers start TCFD-aligned disclosure**

Malaysian authorities have tabled proposed new rules for the inclusion of climate risks in banks' and insurers' risk management processes, notably mandating them to start applying TCFD-aligned disclosures by 31 December 2023 for FY2024.

Segments Impacted: **Banks & Insurers**

+ Singapore

Legislation: **Banking Rules**
Timing: **March 2022: Start of Monetary Authority of Singapore's (MAS) first climate stress testing for banks**

In March 2022, the MAS conducted its first climate stress test on banks which referenced the Network for Greening the Financial System's climate scenarios.

Segment Impacted: **Banks**

Legislation: **Sustainable Reporting**
Timing:

- **June 2022: Banks, insurers and asset managers are expected by MAS to make voluntary climate disclosures**
- **By 2023: All issuers will need to report on a 'comply or explain' basis for financial year (FY) 2022**
- **By 2024: Mandatory reporting for issuers in the financial industry, agriculture, food and forest products industry, energy industry for FY2023**
- **By 2025: Issuers in the materials and buildings industry and transportation industry also scoped in mandatory climate reporting for FY2024**

The Singaporean authorities have finalised their framework for mandatory climate disclosures for issuers built on the TCFD recommendations.
In parallel, the MAS expects financial institutions (banks, asset managers, insurers) to start reporting on climate risks according to the TCFD recommendations from June 2022, however this is not mandatory. The MAS is expected to consult on mandatory climate disclosure rules for financial institutions in the coming months.

Segments Impacted: **Banks, Asset Managers, Insurers & Issuers**

Source: Moody's ESG Solutions; Graphics/Presentation by AICB

+ China

Legislation: **Taxonomy**
Timing: **April 2021: Final version of Chinese taxonomy for green bonds and loans**

In April 2021, the Chinese authorities issued the final version of the *Green Bond Endorsed Project Catalogue* which defines what green bonds are.

Segment Impacted: **Issuers**

For more on Moody's latest insights and analysis on key trends shaping ESG, climate and sustainable finance globally, please visit our Insights and Analysis page.

*https://assets.website-files.com/5df9172583d7eec04960799a/6255a1c173ca566c9da9d291_RegulatoryCalendar_April2022.pdf

+ Indonesia

Legislation: **Taxonomy**
Timing: **2022: Development of voluntary taxonomy**

The Indonesian government is developing its own voluntary green taxonomy in 2022. It classifies economic activities supporting environmental protection as well as climate change mitigation and adaptation.

Segment Impacted:
Financial Institutions

Source: Moody's ESG Solutions; Graphics/Presentation by AICB

+ Hong Kong

Legislation: **TCFD Reporting**
Timing: **Mid 2023: Application of TCFD-aligned disclosures**

Hong Kong is developing climate risk management guidelines for banks. It is building on the TCFD recommendations to classify climate risks as physical, transition and liability risks. The guidelines are expected to be finalised in the coming months. Notably, it indicates its plan to begin mandating banks have TCFD-aligned annual disclosures by mid-2023.

Segment Impacted: **Banks**

Legislation: **Climate Disclosure**
Timing:

- **20 August 2022: Application date of new climate risk disclosures for asset managers with >USD8 billion assets under management**
- **20 November 2022: Application date of full requirements for large asset managers, and baseline requirements for other fund managers**
- **2025: Planned application of TCFD-aligned climate disclosures across relevant sectors**

The Securities and Futures Commission of Hong Kong has developed a mandatory climate risk disclosure framework for asset managers which will be applied in phases from August 2022. The rules largely build on the TCFD recommendations.

Segment Impacted: **Asset Managers**

Legislation: **Taxonomy**
Timing: **2022: Potential adoption of *Common Ground Taxonomy* by Hong Kong**

Hong Kong is planning to adopt the *Common Ground Taxonomy* published by the International Platform on Sustainable Finance on 4 November 2021, which outlined the similarities between the Chinese and EU taxonomies. More details are expected to be outlined in the coming months.

Segment Impacted: **TBD**

+ South Korea

Legislation: **Sustainable Reporting**
Timing:

- **2025: Start ESG reporting for listed companies above a certain size**
- **2030: Start ESG reporting for all listed companies**

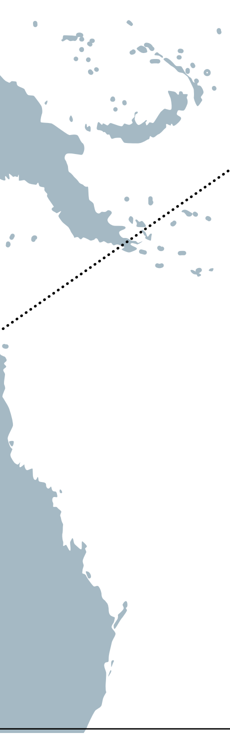
South Korean authorities have mandated ESG reporting for certain listed issuers above a certain size from 2025 and for all listed issuers from 2030.

Segment Impacted: **Issuers**

Legislation: **Taxonomy**
Timing: **30 December 2021: South Korea presented its *Green Taxonomy***

At the end of 2021, South Korea presented its *Green Taxonomy*, which has been in part inspired by the *EU Taxonomy*. However, it notably excludes nuclear from its taxonomy whilst including natural gas.

Segments Impacted: **Issuers & Financial Institutions**



+ Australia

Legislation: **Taxonomy**
Timing: **2022: Start development of industry-led Australian taxonomy**

The Australian finance industry has kick-started the work to develop its own green taxonomy framework.

Segment Impacted: **TBD**

Legislation: **TCFD Reporting**
Timing: **November 2021: Australian banks and insurers can start to use climate risk guidance**

The Australian Prudential Regulation Authority set out its final climate risk guidance for banks and insurers. The guidance is principles-based and aligned with TCFD recommendations. It addresses governance, risk management, scenario analysis and disclosure.

Segments Impacted: **Banks & Insurers**

ABOUT MOODY'S ESG SOLUTIONS

Moody's ESG Solutions is a business unit of Moody's Corporation serving the growing global demand for ESG and climate insights. The group leverages data and expertise across ESG, climate risk, and sustainable finance, and aligns with Moody's Investors Service and Moody's Analytics to deliver a comprehensive, integrated suite of ESG and climate risk solutions including ESG scores, analytics, sustainability ratings and sustainable finance reviewer/certifier services.

For more information visit Moody's ESG hub at *www.moodys.com/esg*.

PEDAL TO THE METAL FOR DIGITAL CURRENCIES

By Kannan Agarwal

All eyes on CBDC pilots.

The central bank digital currency (CBDC) landscape is bursting with activity. In a previous issue of *Banking Insight*, we reported that over 85% of central banks polled by the Bank of International Settlements (BIS) in October 2020 confirmed that they were engaged in some form of work on CBDCs. Coincidentally, around the same time, the Sand Dollar – the Bahamas' digital iteration of its fiat currency – was piloted and China's digital renminbi, the e-CNY, was tested in several cities.

Since then, the pace has ramped-up in the CBDC space, mostly in the wholesale segment, in both emerging and advanced economies. At least 100 jurisdictions are currently experimenting with some form of CBDC, with the most successful demonstrations coming out of those which partner the spectrum of financial stakeholders – banks, non-banks, tech companies, advisory firms – in designing their CBDCs. Here's a round-up of some of the latest experiments:

+ Project Jura: Named after the mountain range along the Franco-Swiss border, this joint CBDC experiment was completed in December 2021 involving Banque de France, Swiss National Bank (SNB), the BIS Innovation Hub Swiss Centre and a private consortium comprising Accenture, Credit Suisse, Natixis, R4, SIX Digital Exchange, and UBS. The project experimented on the cross-border settlement of two wholesale CBDCs (wCBDCs) and one French digital instrument using a distributed ledger technology (DLT) platform. Detailed findings are discussed in the report *Project Jura: Cross-border Settlement Using Wholesale CBDC,* available on the BIS website.

+ Project Helvetia: A joint proof-of-concept by the BIS, SIX, and SNB. It explores how a DLT-based tokenised financial asset could be used to test the settlement of interbank and cross-border transactions. Phase I, concluded in December 2020, demonstrated the veracity of the platform for trading and settlement of tokenised assets; Phase II, completed in January 2022, was expanded to include modelled processes with commercial banks, integration of wCBDC into the system, and running end-to-end transactions. The reports are publicly available on the BIS website.

+ Project Ubin: A collaboration between the Monetary Authority of Singapore (MAS) and Singapore Exchange together with JP Morgan and Temasek to potentially develop more efficient alternatives for the clearing and settlement of payments and securities using blockchain. The five-phase investigation was completed in 2020, including a collaborative phase with the Bank of Canada. The MAS has since shifted its priorities as it announced it would forgo retail and focus its work in the wCBDC segment instead due to constrained demand in Singapore.

+ Project Atom: The Reserve Bank of Australia recently completed its two-year investigation into the potential of wCBDC for syndicated lending, in partnership with banks, one non-bank and a software company. The ethereum-based DLT platform demonstrated that with the appropriate controls in place, wCBDCs removed friction points in loan syndication for larger business customers, whilst automation and digitalisation added to efficiency gains and reduced operational risks.

> The ethereum-based DLT platform demonstrated that with the appropriate controls in place, wCBDCs removed friction points in loan syndication for larger business customers, **WHILST AUTOMATION AND DIGITALISATION ADDED TO EFFICIENCY GAINS AND REDUCED OPERATIONAL RISKS.**

These experiments are part of a burgeoning move to explore how ledger technology can assist in optimising payments and achieving financial resilience goals.

COUNTERING CRYPTO BROS

CBDC projects – retail as well as wholesale – have come a long way since they were first openly contemplated by regulators in 2019, their response in some ways a reaction to Facebook's announcement about designing its own cryptocurrency called Libra. However, that was many moons (and rebrands) ago as the social media behemoth – now known as Meta – has since shelved all cryptocurrency aspirations under an avalanche of privacy criticisms and security concerns, not least by the US Treasury, Federal Reserve, and Congress. This February, the tech company threw in the towel and announced that it was winding down the crypto project in a USD182-million asset sale to NYSE-listed Silvergate Capital Corp, the holding company of a namesake cryptocurrency bank.

Perhaps Facebook/Meta thought that launching its in-house cryptocurrency would attract the same valuations that followed bitcoin and ethereum or gain cult-like status among 'crypto bros', an urban term for someone with a poor grasp of cryptocurrency and/or blockchain but is nonetheless a highly opinionated crypto punter. After all, Facebook/Meta itself didn't have any expertise on cryptocurrency, relying on collaborations and a broad panel of technical members in order to design Libra.

Ironically, the process of scrutinising every aspect of Facebook/Meta and iterations of its stablecoin Libra (later rebranded Diem) has in some measure informed the process of creating an optimal CBDC, one that is governed according to the standards of fiat currency and functions on existing technologies in the financial world.

Ironically, the process of scrutinising every aspect of Facebook/Meta and iterations of its stablecoin Libra (later rebranded Diem) has in some measure informed the process of creating an optimal CBDC, one that is governed according to the **STANDARDS OF FIAT CURRENCY AND FUNCTIONS ON EXISTING TECHNOLOGIES IN THE FINANCIAL WORLD.**

IN THE NOW

The evolving attitudes of regulators and policymakers, who today are actively exploring the potential of CBDCs, was most recently reflected by Italian economist Fabio Panetta, who is also a member of the Executive Board of the European Central Bank.

During a panel discussion on CBDCs at the US Monetary Policy Forum in New York this February, Panetta outlined how centrally issued digital coins can perform an exceptional role in safeguarding public interest and enhancing financial resilience:

"A CBDC would preserve the coexistence of sovereign and private money in a digital world. This is not an abstract benefit – it is the basis for financial and monetary stability, ensuring competition and efficiency in payment markets. But a CBDC could generate even more benefits for users…It could improve the confidentiality of digital payments…

"If a digital currency were offered by an independent public institution such as the central bank – which has no interest in exploiting individual payment data for any purpose – it could enhance, not reduce, the confidentiality of electronic payments. Potential users clearly want this: when we consulted the public on the topic, privacy was identified as the most important aspect of a digital euro. Sound governance arrangements that comply with data protection regulations would ensure that payment information is only accessed for permitted purposes, such as countering illegal activities. We are cooperating with the relevant European authorities on this issue."

The economist also detailed the bloc's vision with regard to financial inclusion: "A digital euro would also increase choice and reduce costs, contributing to a level playing field in payments. Key segments of the euro area payments market, such as cards and e-payments, are dominated by a handful of players, which strengthens their pricing power. Some estimates suggest that Europeans pay about 1.4% of gross domestic product for payments services. In the United States, the costs are higher.

"One might argue that private service providers are already well equipped to offer low-cost digital payment solutions. However, the limited evidence available suggests that low-income households use digital payments less than high-income households. This is consistent with the hypothesis that digital payments remain expensive for many users. And even in advanced financial systems, many citizens are 'unbanked' or 'underbanked'. Although financial inclusion depends on several factors, such as financial and digital literacy, the cost of financial services is likely to play a role.

"Our digital euro project comes with a commitment that all – including vulnerable population groups – will have access to safe public money in the digital era."

This captures the motivations for central banks in emerging and advanced economies to embark on their respective digital currencies in a hyperconnected world.

ARCHITECTING TRANSFORMATION

Acknowledgement that CBDCs can help modernise the global monetary and payments landscape, regulators and policymakers are working shoulder to shoulder with industry to address risks in order to support this transition. These risks are neatly summarised by London-based Finextra Research in a January 2022 paper:

> **ECONOMIC RISKS.**
- **Inflation.** A CBDC can inflate the money supply without any corresponding increase in GDP. This risk can be mitigated by issuing CBDC to individuals and businesses only in return for bank deposits or collateral paid for with bank deposits; and to government only in return for bonds that have a reasonable chance of being repaid through taxes.
- **Large-scale misallocation of capital and effort.** CBDCs require nationwide infrastructure for distribution and payments. There is a risk that CBDC infrastructure that is designed and built by bureaucrats (separate from private sector initiatives) will result in low adoption of CBDC due to poor utility and poor user experience.

> **FINANCIAL RISKS.**
This includes exchange rate risk, higher lending costs, and operational risks. In its recent discussion paper *New Forms of Digital Money,* the Bank of England identified increased lending costs as a risk due to a possible decrease in bank lending using CBDC and an increase in more expensive market-based financing. There is also the risk of a centralised CBDC system suffering outages and cyberattacks.

> **HUMAN RIGHTS RISKS.**
If designed inappropriately, CBDCs could be used as tools of surveillance and control. Every transaction is recorded and any authority with access to the CBDC ledger could see all transactions. The combination of digital identity and CBDC is also a big risk. Access and addressability are needed for digital payments, but these are different to digital identity. In a world of programmable money, digital identity can go beyond just enabling access to your funds. While digital identity is needed to find fraudsters, money launderers, and other criminals, there is no monetary reason to combine CBDC with digital identity.

PILOT

Since 2019, the People's Bank of China (PBOC) has moved to the next stage with its sovereign digital currency, e-CNY. This January, the central bank announced that home-grown tech giants Alibaba and Tencent will make the CBDC available as a payment method on their mobile platforms, Alipay and TenPay, respectively.

The PBOC's own app, a digital wallet for the e-CNY, has now been piloted in 10 major cities, including Shanghai and Beijing. Users choose between individual or corporate wallets, each bearing different transaction limits. There are also options for either a software-based platform (mobile app) or hardware-based via an electronic card.

Although China, like her peers, have remained technology agnostic, the e-CNY is currently built on a centralised ledger, however this does not rule out the possibility of **TRANSITIONING TO A PERMISSIONED DISTRIBUTED LEDGER TECHNOLOGY IN THE FUTURE**. National rollout is still some ways off, but the country is ahead of its global peers.

Although China, like her peers, have remained technology agnostic, the e-CNY is currently built on a centralised ledger, however this does not rule out the possibility of transitioning to a permissioned distributed ledger technology in the future. National rollout is still some ways off, but the country is ahead of its global peers. The digital currency's use was tracked during the winter Olympics to test scalability and throughput.

Speaking to the Atlantic Council GeoEconomics Center this February, Mu Changchun, Director General of the Digital Currency Initiative at the PBOC, states that the e-CNY rate of 10,000 transactions per second (TPS) outstrips Visa's 1,700 TPS by a mile, but is far behind AliPay's 544,000 TPS rate and will be beefed up to 300,000 TPS soon.

On the wCBDC front, Mu says: "We have already developed the mBridge project [a multilateral CBDC platform that supports instant cross-border payment in multiple currencies and multiple jurisdictions]…At the same time, we have strict capital management matters in place."

It is also crucial that China's digital currency be accurately designed to ensure greater financial resilience in case of disruption to its domestic payment ecosystem, which is currently dominated by AliPay and TenPay. The Atlantic Council notes in a March 2022 report that the current e-CNY structure has several disincentives that could hamper widespread adoption: unlike Renminbi holdings, it does not carry any interest, is not covered under the national deposit insurance mechanism, and could be subject to a small fee for frequent withdrawals from the platform under times of financial distress.

Even at the forefront of CBDC, there's ample room for growth and improvements in all aspects of its design and rollout. What's certain is that the shift is coming and, by the looks of it, sooner rather than later. ✱

■ *Kannan Agarwal is a Singapore-based researcher with Akasaa, a boutique content development firm with presence in Malaysia, Singapore, and the UK.*

By Christophe Barel

Financial institutions must act in concert to defend against threat actors.

READY FOR WHATEVER COMES: MOVING TOWARDS CYBER RESILIENCE

In a rapidly evolving and increasingly fraught cyberthreat landscape, financial institutions are doubling down on cybersecurity, especially amidst rapid digital adoption that has greatly expanded attack surfaces. But with the ubiquity of cyberthreats and growing likelihood of attacks, protecting data is not enough. Financial firms must be able to keep operating even in the face of cyberattacks. They must be cyber resilient.

Cyberthreats are increasingly intertwined with geopolitical conflicts. In the current invasion of Ukraine by Russia, cyberattacks are part of a multipronged approach to modern warfare.

Furthermore, the pandemic has accelerated digitisation, where firms increasingly rely on third-party suppliers of software and infrastructure, vulnerabilities proliferate, and cybercriminal tactics continuously adapt and evolve. In this complex cyberthreat landscape, it is urgent for financial firms to prioritise cyber resilience and preparedness.

Cyber resilience is not only about sustaining operations even while under attack; it is about trust.

In financial services, maintaining customer trust is paramount; we would have no business without it. We are seeing a trend in Asia-Pacific of appointing trust officers to executive leadership roles to oversee privacy, security, and risk management. Cyber resilience is a key focus of their remit.

Furthermore, the pandemic has **ACCELERATED DIGITISATION, WHERE FIRMS INCREASINGLY RELY ON THIRD-PARTY SUPPLIERS OF SOFTWARE AND INFRASTRUCTURE,** vulnerabilities proliferate, and cybercriminal tactics continuously adapt and evolve. In this complex cyberthreat landscape, it is urgent for financial firms to prioritise cyber resilience and preparedness.

BUILDING THE MUSCLE MEMORY TO RESPOND

Just as sports teams study their opponents' strategies and practice defending against them, financial firms increasingly use cyber exercises to test their response capabilities and expose their weaknesses in a simulated environment, so they can strengthen their defences before a real-world attack hits. Exercises occur at firm, sector, and cross-sector levels and practise responding to many different scenarios. The goal is not to predict exactly what might happen, because no attack happens exactly the same way twice. Rather, the objective is to help firms build frameworks for response so the organisation is well-prepared for what may come.

For example, Locked Shields, the world's largest international live-fire cyber exercise run by The North Atlantic Treaty Organization's Cooperative Cyber Defence Centre of Excellence, puts countries' cyber defence systems to the test with sophisticated cyberattacks on complex networks that accurately mimic the cross-border nature of today's cyberthreats and the tools, techniques, and procedures of relevant real-world threat actors. Large-scale exercises such as Locked Shields facilitate systematic, cross-border, multi-industry, public-private cyber defence collaboration and information sharing to build cyber resilience globally.

As the only global cyber intelligence sharing community solely focused on financial services, the Financial Services Information Sharing and Analysis Center (FS-ISAC) participates in and runs cyber exercises on a variety of industry sub-verticals such as payments systems and insurance. These exercises not only enhance firms' understanding of their vulnerabilities and help improve incident response plans, but also help firms benchmark their responses against peers to see where their capabilities stack up.

Post-exercise, After Action Reports help spread key learnings and recommendations among participating institutions and beyond. Exercises are therefore part of a virtuous cycle of information sharing that help financial firms increase their cyber resilience and preparedness.

INFORMATION SHARING IS ANOTHER KEY PILLAR OF CYBER RESILIENCE. In today's cyberthreat landscape, no one firm can predict all threats all the time. It is imperative for firms to share not only threat intelligence on new tools, techniques, and procedures being used by cyberthreat actors, but also best practices to defend against them.

DARE TO SHARE

Information sharing is another key pillar of cyber resilience. In today's cyberthreat landscape, no one firm can predict all threats all the time. It is imperative for firms to share not only threat intelligence on new tools, techniques, and procedures being used by cyberthreat actors, but also best practices to defend against them.

Both finance and cyberthreats are inherently cross-border by definition. In our sector, information sharing must happen at a global level so that a threat that begins in one part of the world can be prevented and defended against in another. Further, having a network of peers helps support knowledge building of the threat landscape and known prevention and mitigation measures, which is especially crucial given the global cybersecurity talent shortage. Finally, information sharing on trusted platforms allow well-resourced cybersecurity programmes to share their expertise with less mature ones. This is critical because even attacks on smaller institutions can damage public trust in the larger financial system. Therefore, it is incumbent on the entire sector to help protect and defend all participants.

NEVER TRUST, ALWAYS VERIFY

In a rapidly digitising world where financial firms rely on a wide array of third- and fourth-party suppliers, a zero-trust model helps put in place protocols that ensure constant vigilance. Zero trust means that access to applications and data is denied by default and is only granted through continued multifactor authentication and risk-based verification among users and devices.

Adoption of the zero-trust model has seen a slow start in Asia-Pacific, amid a unique cultural context that is built on trust and consensus as well as a highly competitive business landscape. However, a survey cited in a March 2022 report shows that zero trust is gaining momentum; while only 8% of Asian organisations had adopted a zero-trust strategy, 82% had plans to implement one in the next 12 to 18 months.

NOT IF, WHEN

Since we can no longer assume that it is possible to prevent all cyberattacks, we must therefore develop robust incident response and business continuity plans that help us respond to and recover from attacks as quickly as possible with minimal disruption to business services. Having integrated tools that allow for smooth and efficient incident response throughout the chain of command, from the front line defenders up to the executive level, is increasingly critical to business success.

BOARD-LEVEL PRIORITISATION

Cybersecurity is no longer just a back office cost; it is a critical business risk and must be treated accordingly. To date, many boards have seen the importance of cybersecurity but do not understand it and so give the chief information security officer (CISO) whatever budget is asked for in the hope that money will 'fix it'. That approach will no longer suffice. Regulators are increasingly demanding accountability at the board level; therefore, boards must educate themselves on cyber risks. More and more CISOs will be invited to corporate boards to incorporate the required cyber expertise into board compositions. But CISOs too must understand how to quantify cyber risks in financial terms that boards know how to work with.

If there are lessons to be taken from the Covid-19 pandemic for cyber defence, it is that black swan events – unexpected, outlier events with severe impact – can hit any institution. While mitigation measures are essential, it is crucial not to stop there. Cyber resilience comes with regular participation in cyber exercises, playing an active role in cross-border intelligence sharing, and maintaining well-drilled incident response teams to be able to keep operations running even if faced with cyberattacks. ✱

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■ *Christophe Barel is the Managing Director for Asia-Pacific at FS-ISAC, the only global cyber intelligence sharing community solely focused on financial services. Serving financial institutions and in turn their customers, the organisation leverages its intelligence platform, resiliency resources, and a trusted peer-to-peer network of experts to anticipate, mitigate and, respond to cyberthreats. Headquartered in the United States, the organisation has offices in the United Kingdom and Singapore, and members in more than 70 countries.*

Prior to joining FS-ISAC, Christophe was Managing Director at data and intelligence provider Acuris Group where he has set up their risk & compliance business for Asia-Pacific, focusing on areas such as AML/KYC screening, cybersecurity and enhanced due diligence. Christophe has been based in Asia for about a decade, starting off in Hong Kong before moving to Singapore in 2015. Previously, he worked for a variety of consulting and tech companies.

Supply Chain Critical

By Chartered Banker Institute, UK

Corporates are tending to their supply chains with increased care and attention – something financial services providers are only too keen to help them get right.

The supply chain is a simple enough concept: a business works with a series of different suppliers to help construct a product or service that then relies on being sold on to various buyers. The timing, location and financing of all the necessary components needed to come together to make things happen, all stand or fall on the ability of everyone across the chain to execute and manage their responsibilities sufficiently well.

Unfortunately for businesses of all sizes, the realities of factors outside their control – from sudden geopolitical shocks, to legislation, environmental or natural disasters – have made supply chain management a business-critical issue that is now a strategic as well as a logistical concern.

For financial services providers, the change in focus over the past decade to prioritise a more holistic engagement strategy with corporate banking customers has brought with it various opportunities. These include building out more innovative financing instruments that can help support the cash flow and working capital needs for the ambitious company with targets to meet.

With this in mind, supply-chain-specific financial products have gained much traction in recent years as an enlightened solution to the commercial challenges companies face in navigating increasingly complex supply chains.

But what does supply chain finance (SCF) currently look like and what makes it a compelling proposition for businesses?

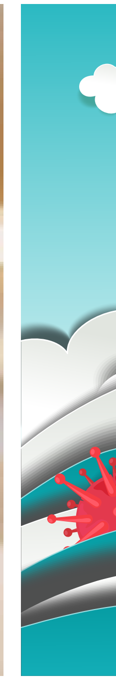
Matthew Davies, Director of Invoice Finance & Asset Based Lending, UK Finance, says that, although it is often referred to as 'reverse factoring', the term actually encompasses a greater diversity of products intended to help free up cash across the supply chain.

"Everybody typically defines SCF slightly differently," he points out. "But at a high level we would define it as simply a buyer-led finance facility – where it is put in place by the corporate buyer of goods or services in order to support the businesses that supply it. It can be provided

on a reverse factoring basis, but that's only part of the story.

"Generally, the corporate buyer would set up an SCF scheme with a funder – often but not always a bank – so that its suppliers can elect to get approved invoices ahead of terms. The funder is there to bridge the gap until the invoice would be contractually deemed payable, whether this is 30 or 60 days or whatever is agreed.

The counterparty will essentially be the buyer – usually a corporate – rather than the suppliers. Used in this way, Davies adds, the suppliers can benefit from the buyer's often higher credit rating to obtain cheaper finance and the buyers can support their supply chain without impacting their own balance sheet and cash flow. But while SCF is not new, the opportunity or willingness among corporates to use it has not been so clear cut.



A myriad of limitations – from their over-reliance on old, paper-based processes to a lack of understanding as to how it can work for them – has hindered its uptake. Davies argues that technology and digitalisation have become a principal driver in helping present the case for SCF.

"SCF has been 'the future' for a number of years, and until now it has never quite realised that goal," he says. "Technology is finally making it more accessible." This viewpoint may just have been borne out by the research. According to a report carried out by supply chain technology firm Taulia, 38% of companies were using SCF in 2021 to ensure smooth payments, compared with only 19% in 2018. Additionally, interest in the process has grown to 22% in 2022 from 15% in 2018.

Davies' colleague at UK Finance, Director of Commercial, Mike Conroy, echoes the "enormous potential" for SCF, describing it as a "helpful means of releasing finance into the market". He argues that the importance of resilient supply chains is greater than ever, particularly for financial resilience, and the facility is welcome among those companies deeply embedded in highly complex Asian supply chains.

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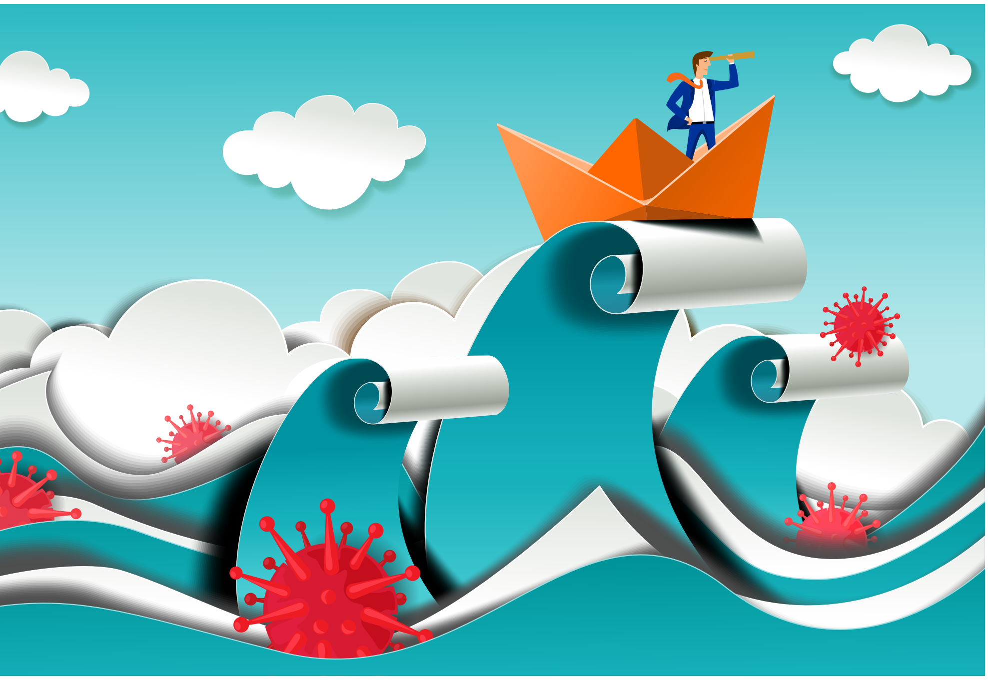
"People are starting to realise that it can be a very effective form of finance," he says. "As the UK looks to trade in other parts of the world – particularly in Asia – then we can see this shift of supply chains into places such as Vietnam, Bangladesh and Indonesia where we're seeing rapid growth.

"The challenge is, that to get it to work really well, you need to tap into the sort of technological and digital advances that enable you to track goods, determine what is where, and enable it to be financed."

Again, the numbers are suggesting that the corporate community likes what it sees in the SCF space. The volumes involved in SCF have hit USD1.31 trillion in 2020, according to Boston Consulting Group's *World Supply Chain Finance Report* for that year. Banks and lenders are also riding high on the potential for expansion: revenue from SCF programmes is predicted to have a compound annual growth rate of 3.2%, reaching USD11 billion by 2030.

Davies and Conroy report large SCF clients from sectors including telecoms and construction in particular as fitting examples of its success. Many of the large UK and international banks are big players in the sector, along with a number of specialist bank and non-bank providers.



EVERYTHING WORKS FINE UNTIL IT DOESN'T!

While there is an understanding that technology in itself has accelerated the momentum behind SCF as a proposition, other external pressures have more recently conspired to push the issue of supply chain resilience to the top of the boardroom agenda. Supply shocks, whether environmental, viral or logistical, have come at quite a pace over the past three years or more, something that Davies and Conroy recognise as causing a tangible uplift in interest.

"We did detect a more enlightened approach to supporting supply chains at the onset of the Covid pandemic," says Davies. "This was probably a combination of altruism as businesses recognised we're all in this together, with a more pragmatic reaction to the limitations of 'just-in-time' supply models."

But events such as the blockage of the Suez Canal by the container ship Ever Given, part of the Evergreen fleet, last March, or even the risks surrounding ongoing military conflict, are also a timely reminder of the vulnerabilities businesses need to work around on a daily basis. It's the tight integration of supply chains that can on occasion be their downfall when faced with shock events.

As Davies points out: "Everything works fine until it doesn't! And it is times like these that the real challenges come to light. Plan A is no longer good enough."

The immediate impact of Brexit also provides a salutary lesson to UK buyers and suppliers, following the initial growth in red tape that has forced a fresh awareness of needing to maintain resilience. "Combine the challenge of getting goods from A to B with the added complication of the pandemic," says Conroy, "and shortages can creep quickly into consumers' lives."

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Director of Invoice Finance & Asset Based Lending, UK Finance.

A SELLER-SIDE VIEW

For Ian Tandy, Managing Director, Global Trade & Receivables Finance, HSBC UK's Global Trade & Receivables Finance division, shock events are simply part of a longer continuum of developments that have prompted corporate clients' interest in SCF. Put simply, the direction of travel has for a number of years already been towards a growing recognition that the strategic imperative behind good supply chain management often calls for complex financing solutions from banks.

Tandy explains: "If we look back to the recent trade challenges concerning China, EU and US, as well the impact of Brexit on UK trade policy, which involved negotiations right up to the last minute; the rising costs of transportation linked to the pandemic, which had left ships effectively caught in the wrong part of the world, and increasing commodity prices – the reality of the situation is that companies have had to think very carefully about what they're sourcing from and what their sourcing plan is moving forward.

"The biggest single impact I have seen is companies increasing their focus significantly on supply chain. Supply chain, its costs and the potential disruption associated with it, have become a C-suite issue. Before, supply chain management was sufficiently smooth to run a just-in-time model in many sectors. Now, the challenges being thrown at businesses at an ever-increasing frequency mean they need to be nimble in their thought processes."

In Tandy's view, the bounceback following the pandemic in the UK has been strong and this has led to plenty of opportunities for business to sell their goods and services. The changed landscape post-Brexit, too, has not knocked the confidence of the business of international trade.

"After Brexit was finalised," he continues, "we worked with businesses to get a sense of what new opportunities they could see – and what we have seen is that the global supply chain is pretty resilient, save for a few notable examples such as shipping or semiconductors.

"To me, this is a clear demonstration that businesses have really thought deeply about where they are, where they're buying from and where they're selling to. They have put together strategies to reduce the risks wherever they may arise and I think they have been incredible in the face of those challenges coming in thick and fast."

For the larger international traders, Brexit is just one element of a range of external forces they face. They have been confronted with the complexities of international trade for many years, and for those companies that were previously operating exclusively within what was a larger domestic economy, they are rediscovering a global way of doing business.

This, for Tandy, is where banks are naturally keen to provide support.

"Before the various challenges we have been facing in the past seven years, supply chains were very lean. Companies have moved from a just-in-time model where everything had worked more or less seamlessly, to a just-in-case model. We're seeing increasing inventory being held, and businesses are much more likely to prepare for any likely supply chain disruptions by thinking more carefully about where and when they buy."

HSBC can point to its presence in 53 markets when it comes to understanding the vagaries of good supply chain management. The Chinese market is clearly strong territory for the bank, and that intelligence can go far in shaping the bank's conversations with corporate clients, who strive for a deeper level of market awareness in decision-making.

"Shipping times have been extended significantly, for example," adds Tandy. "So, if a business pays at the point of shipment and that shipment takes 50% longer than previously, it eats into the working capital. At its fundamental level, it's this understanding that we believe businesses are looking for from banks."

PUSHING THE SUSTAINABILITY BUTTON

However, one of the most marked changes in the SCF story has been the opportunity for banks and providers to respond to the global urgencies of social, climatic and environment risk by applying sustainability metrics to the finance models available.

For the larger international traders, **BREXIT IS JUST ONE ELEMENT OF A RANGE OF EXTERNAL FORCES THEY FACE.** They have been confronted with the complexities of international trade for many years, and for those companies that were previously operating exclusively within what was a larger domestic economy, they are rediscovering a global way of doing business.

UK Finance's Conroy agrees that the sustainability imperative is undoubtedly helping reshape SCF as a product for the better.

"Larger purchasers will invariably bear the brunt of reporting requirements when demonstrating progress against net-zero targets, for example – so you can see that support from their suppliers to meet these requirements could be formalised more successfully via an SCF programme," he explains.

"Supply chains are highly integrated into processes for large firms, so SCF is a natural extension of the drive to improve them. Without doing so, valuable time can be wasted trying to find solutions outside the finance ecosystem to validate sustainability requirements."

The application of SCF, in Conroy's view, should be a seamless addition to all businesses, with an eye on strong ethical and sustainable – as well as commercial – performance.

For its part, HSBC has advanced its sustainable SCF products with enthusiasm to meet the challenges of the time, but as those challenges shift, providers overall are needing to adapt

accordingly to ensure the client gets what they need.

The metrics of 'good' ESG and sustainability are, however, also a moveable feast. In one major initiative, HSBC in the US joined forces with Walmart to try to address the long-standing dilemma of how to measure positive sustainable impact by aligning science-based emissions reduction targets to the company's supplier SSCF (sustainable supply chain finance) programme, itself running since 2019. The overall objective is that Walmart suppliers can access better financing terms if they meet the set targets, but the message is clear: goals have to be authentic and verifiable to mean anything.

"ESG and sustainability is such a huge challenge for all of us, whether in business or not," says Tandy. "But of course, companies themselves are asking, 'Where are our suppliers?' and, 'Where are our customers?' as well as, 'What is the environmental impact of working with them in this way?'

"Sustainable SCF is still evolving in the UK," he adds, "but it's becoming a more frequent conversation across our client base. But, in essence, it's a natural extension of the conversation we have anyway about where their tier one, two and three suppliers are.

"Those businesses that want to ensure that their sustainability principles are embedded through their supply chain, can work with banks' ways to utilise that information, and introduce strategies such as incentivisation of suppliers to help them adhere to their principles."

"**ESG AND SUSTAINABILITY IS SUCH A HUGE CHALLENGE FOR ALL OF US**, whether in business or not. But of course, companies themselves are asking, 'Where are our suppliers?' and, 'Where are our customers?' as well as, 'What is the environmental impact of working with them in this way?'"

Ian Tandy
Managing Director, Global Trade & Receivables Finance, HSBC UK's Global Trade & Receivables Finance division.

WHAT DOES FUTURE SUCCESS LOOK LIKE?

UK Finance's Davies is optimistic about the potential of SCF as a product, especially in the sustainability space – though the challenge remains cascading it down through extended supply chains.

"Some of the bigger buyers have done well so far in getting SCF integrated into their tier one suppliers. But how do we ensure the benefits are passed further down the tiers in supply chains, particularly to the smaller businesses that may need the most support? Again, technology is making SCF more viable to cascade down the supplier ecosystem, and make it more accessible for mid-market buyers too."

"Digital tech has simply transformed the supply chain landscape," agrees HSBC's Tandy. "Digitalisation and the ability to utilise that data and insight for good, has become a priority for businesses across the board.

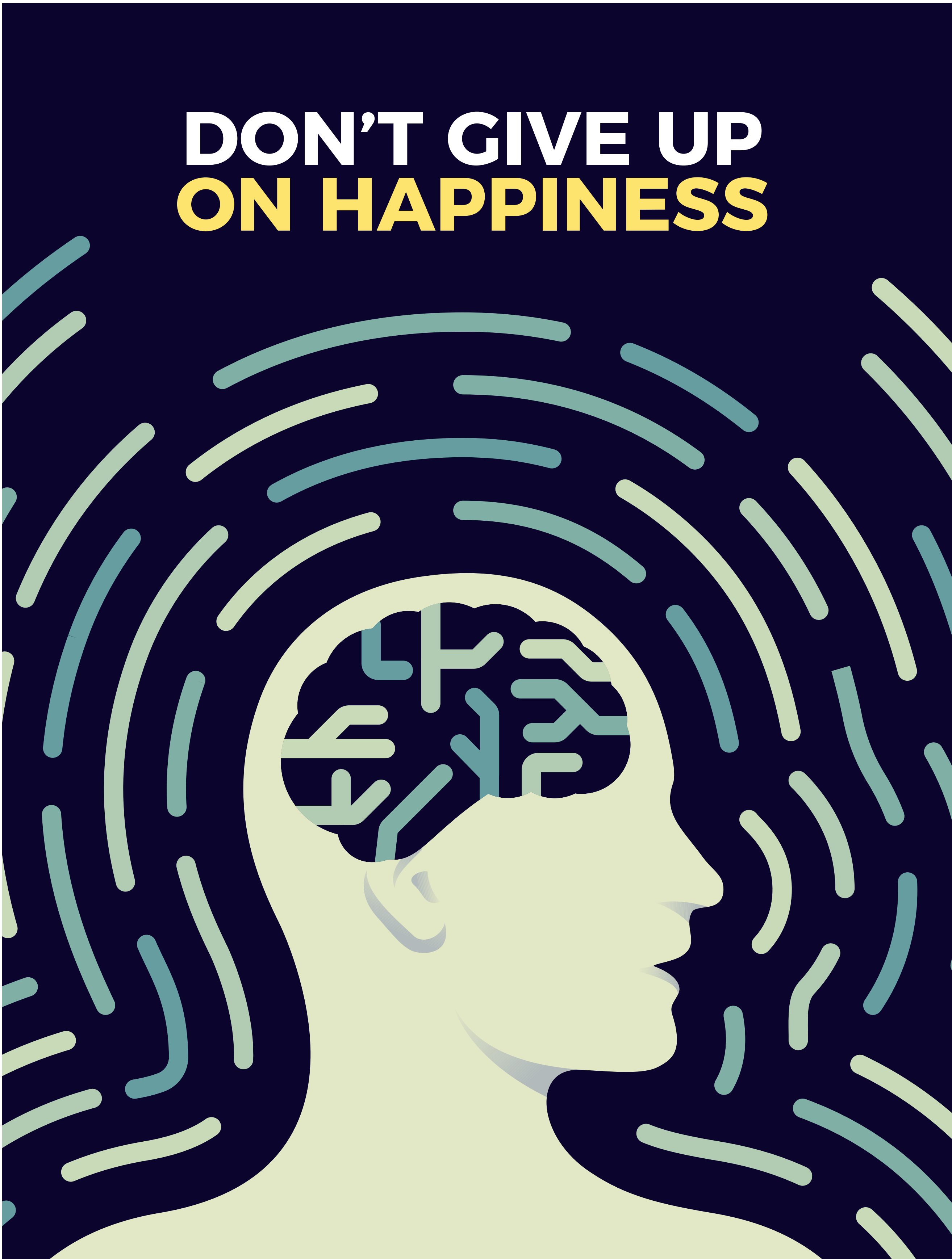
"The principles of global trade of course haven't changed – but technology has smoothed the way. It's easy, too, to forget the background impact of legal and regulatory pressures that are brought to bear on SCF's continued evolution.

"It's helpful that we've seen real interest from the UK government in the transformation towards digital trade – its priority is efficiency and visibility, and ideally, all the players that are involved in getting goods from A to B, can eventually work to a consistent framework."

Global trade has always been rules based, he concludes – whether from the standardisation of shipping containers or recognised payment protocols. It's simply the opportunities afforded by their continued digitalisation that are cause for excitement in an area with much promise. ✱

■ *This article previously appeared in the Chartered Banker magazine, UK, Spring 2022 edition.*

DON'T GIVE UP ON HAPPINESS



By Dr Amanda Salter

Well-being may seem elusive, but necessity is the mother of invention. These new initiatives give hope.

Financial institutions have weathered the Covid-19 storm and emerged with a marked increase in empathy and better ability to handle extremely challenging emotional situations. On the customer side, banks have supported young people who lost their job and their income, and older people struggling with illness and increased healthcare bills. On the employee side, they have supported staff in a major upheaval of working practices, with all the mental health side effects that can come with this such as anxiety, stress, and depression.

I have seen first-hand how easy it is for someone to fall through the cracks. A close friend of mine was, as she thought, happily employed on a zero-hour contract (where the employer is not required to provide a minimum number of work hours). When lockdown kicked in, her employer's workstream dried up. Promises of other work didn't materialise. Her income disappeared and she was unable to pay her rent. She couldn't access any of the government's coronavirus impact funding because she had not been working with her employer for long enough. Her letting agent became threatening and refused to undertake essential repairs. She caught the virus before vaccines were available, recovered slowly, and is still occasionally battling fatigue. She is finally now back on her feet after a long and extremely stressful 24 months. This is a well-educated, experienced, financially prudent, hardworking, professional.

As a bank trying to reduce all these challenges down to a more manageable level, it may seem tempting to revert and focus purely on the financial aspect of well-being. Before you do this though, take a look at the latest ANZ research from December 2021. This study shows that the biggest factor influencing financial well-being of adults in Australia by far is socio-economic conditions.

Socio-economic factors, including health, unemployment, and earning potential, account for 54.5% of the variation in someone's overall financial well-being, whereas behavioural traits such as impulsiveness, optimism, or frugality account for only 13.4% (see **Figure 1**).

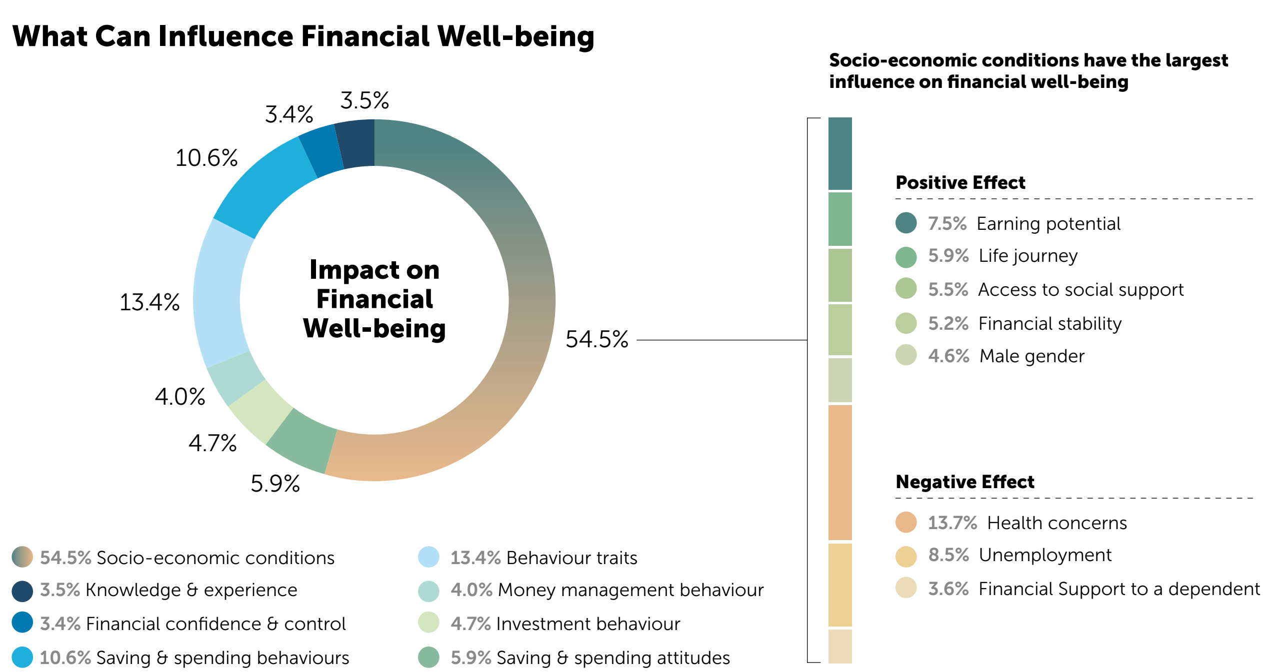


Figure 1: Factors that influence financial well-being.
Source: *ANZ 2021 Adult Financial Well-being Survey – Australia.*

The research challenges the common assumption that someone's financial behaviour and knowledge make the most impact to their financial situation. In this view, financial well-being is holistic and co-dependent – many factors work together and if one is impacted, the entire boat is rocked. This research implies that we need to take a broad approach to well-being; explore initiatives to support physical and mental health, increase earning potential, and drive employment. To truly improve financial well-being, a preventative approach is needed to address these factors, instead of trying to shut the door after the horse has bolted.

With necessity being the mother of invention, many exciting initiatives and resources are moving the dial on well-being in this post-pandemic era. In particular, some tech-inspired innovations have addressed the broad spectrum of well-being highlighted by the survey. Below, we spotlight just a few examples:

- **Language analysis to identify mental health issues**

Poor health is the most significant disruptor to financial well-being. Having an illness causes disruption to someone's ability to work and leads to increased health costs – a double whammy. Even if someone is actively saving, and not borrowing to buy everyday expenses, a major health event can nullify the impact of these good behaviours.

This is a huge signal for banks to pick up on the preventative physical and mental health agenda, not only for their customers but also for their employees. New technologies in digital therapeutics and artificial intelligence (AI) already exist that can listen in on conversations and flag when someone is at risk of depression even if they may not realise it themselves. Health technology companies such as Sonde Health's solution uses vocal biomarkers to score a person's mental fitness and has been shown to be twice as accurate at detecting mental health issues compared to human practitioners.

This is life-saving technology and banks are well placed to use it. Banking systems facilitate millions of digital conversations every day, with both customers and employees. Every Microsoft Teams meeting and every customer-support webchat can already be automatically transcribed. We need only take one step further to feed these conversations through an AI and flag people who are at risk to hand them to the right support channel.

- **Smartphones and statistics to monitor mental health remotely**

Another science called digital phenotyping uses smartphones and other wearable devices to capture data on a person's behaviours, identifying symptoms relating to mental illness. The amount of screen time someone is using, their browser history, their activity levels, sleep patterns, exercise, and social interactions, are all data points that are used to build a picture of how someone is feeling (see **Figure 2**).

This data, coupled with statistical learning techniques, can indicate or predict an inclination towards anxiety, stress, loneliness, or depression. The model is not without its weaknesses, but the potential is huge. This makes it possible for an individual's mental health to be monitored and assessed remotely, thus leading to more preventative, customised, and responsive care. Australia's Black Dog Institute – a not-for-profit facility for the diagnosis, treatment, and prevention of mood disorders – is using similar technology as part of their research to prevent suicide and improve workplace mental health.

Technologies such as these

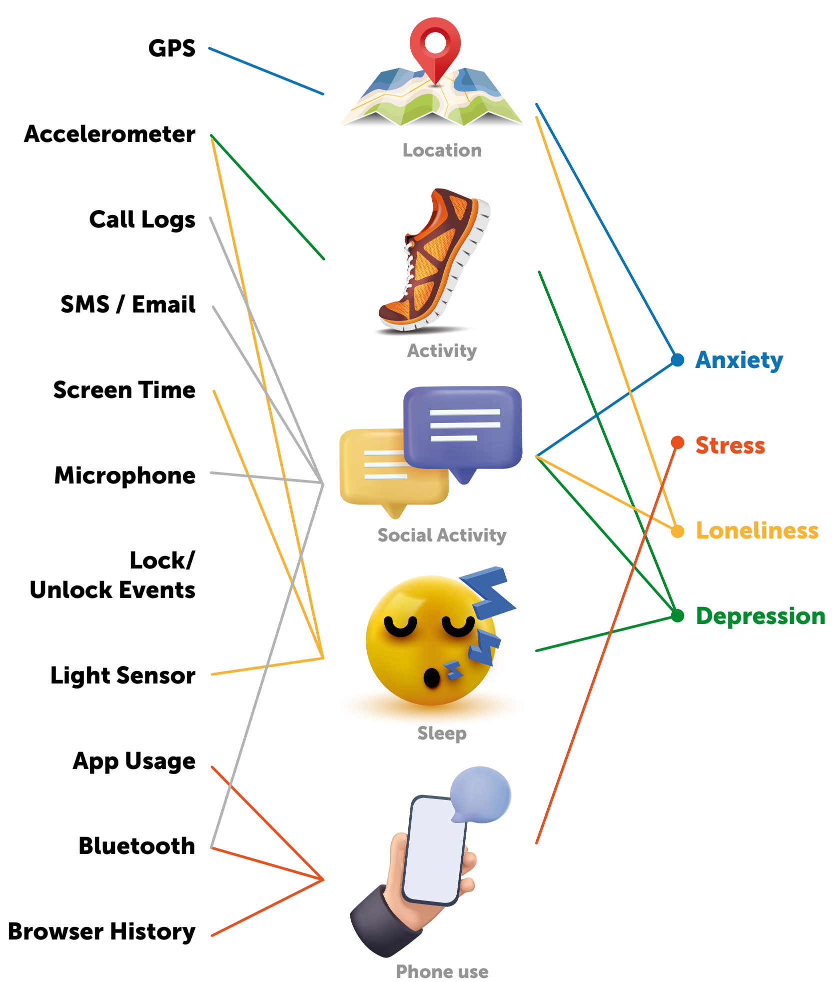


Figure 2: Using smartphones to detect mental illness via digital phenotyping.
Source: *Evidence-based Mental Health*, The BMJ, Torous et al.

complement the range of corporate social responsibility (CSR) initiatives by financial institutions such as HSBC Life, the insurance arm of the bank, whose latest move in May 2021 in partnership with dacadoo, a Swiss healthtech and insurtech company will see it utilising the latter's 'health score'. The technology provides a real-time snapshot of a customer's overall well-being, including physical, mental, and financial aspects. Users of HSBC's Well+ platform and mobile app can thus be empowered to make more informed decisions on a moment-by-moment basis.

- **Education to empower community healthcare workers**

As hospitals strain at the seams, there is a higher likelihood that many people will end up managing their conditions at home, isolated from clinics and hospitals. These people still need support, and again technology is rising to the occasion. Non-profit organisation Last Mile Health uses smartphone technology to support local trusted community members to deliver health services to their neighbours, preventing, diagnosing, and treating a range of everyday medical conditions and diseases from malaria to diarrhoea. This works to overcome challenges at a local level associated with illiteracy, social exclusion, and social division, promoting social trust in healthcare delivery.

Non-profit organisation Last Mile Health **USES SMARTPHONE TECHNOLOGY TO SUPPORT LOCAL TRUSTED COMMUNITY MEMBERS TO DELIVER HEALTH SERVICES** to their neighbours, preventing, diagnosing, and treating a range of everyday medical conditions and diseases from malaria to diarrhoea.

- **An app that connects communities to address loneliness and isolation**

The pandemic has driven up social isolation and stress levels, causing significant psychological damage to many. To address this, the UK's National Health Service (NHS) moved quickly to repurpose an existing smartphone app called GoodSAM, originally created to provide immediate cardiac arrest support via trained first responders living in the local community. When Covid-19 hit, the NHS extended it to become a deployment app for 750,000 community volunteers, matching volunteers to nearby people in isolation who need help, whether for shopping, prescription pickups, or just a chat on the phone. This service didn't just meet the immediate practical need. New research from the London School of Economics show that these small acts of kindness boosted volunteers' well-being and increased their feeling of belonging within their local communities.

A bank that partners with community initiatives such as these would have a massive positive impact at ground level, especially for those in remote underserved areas; another genuine way of enhancing financial inclusion.

- **Virtual job coach to drive down unemployment**

Unemployment is the second largest disruptor to financial well-being and the pandemic has taken its toll, causing a loss of 81 million jobs in the Asia-Pacific region in 2020. Hope is available in new AI-driven solutions that help jobseekers to get employed. One example of this is 'Bob', a digital job coach. Winner of the UK's Nesta CareerTech Challenge Prize 2021, Bob analyses information about jobseekers' needs and the challenges they face. Bob then helps jobseekers to understand how their skills and job application techniques fit with employers' requirements. Jobseekers receive ongoing digital coaching and motivation via email, text, and a personalised app. In trials, 50% of jobseekers reported that Bob's coaching was a key factor in finding a job.

For banks, investing in employment initiatives is beneficial to increasing income stability, preventing defaults, or discovering new talents for its own hiring needs. A digital solution like Bob would be easily scalable to meet demand. Barclays' LifeSkills programme is in its ninth year of operation, and provides online and app-based training, courses, workshops, and other interventions to drive up employability for people with low literacy, those who have been off work from illness, and women coming into employment from the criminal justice system, to name a few of their target segments. By 2020, 11.7 million learners had participated in LifeSkills since the launch of the programme.

- **Digital higher education to increase earning potential**

Earning potential refers to the factors that contribute to someone's ability to earn a higher income. This is often related to their level of post-secondary education. The pandemic has pushed higher education establishments to go digital much quicker, in the face of cancelled in-person courses. There is already a revolutionary move towards rapid development of massively open online courses (MOOCs). MOOCs are purely digital, online, and career focused. They use AI to automatically grade assignments, which massively reduces faculty labour and pushes down costs. These digital platforms can scale up to thousands of students, thus democratising higher education. Courses are broken down into transferrable micro credits, which make gaining certifications more accessible and flexible.

If banks can get behind this and provide access to affordable and accessible higher education for all, aside to the obvious CSR benefits, this could push up their customers' and employees' earning potential, an obvious plus to banks in the long term. Santander is already on board with this cause, investing EUR106 million in 2021 through partnerships with nearly 1,000 universities and institutions across 15 countries.

> Any use of artificial intelligence requires strong privacy policies, data ethics guidelines, and governance processes to be in place. **DIGITAL INITIATIVES THAT STORE AND ANALYSE IDENTIFIABLE CUSTOMER OR EMPLOYEE DATA** should seek explicit consent from each customer or employee from the outset.

These are exciting and inspiring possibilities, but before jumping in with both feet, we pause a moment to consider the downsides. Any use of artificial intelligence requires strong privacy policies, data ethics guidelines, and governance processes to be in place. Digital initiatives that store and analyse identifiable customer or employee data should seek explicit consent from each customer or employee from the outset. This may be tricky to obtain depending on the context. Would you as an employee agree to allow your employer to screen your Microsoft Teams meetings to spot signs of mental illness in your conversations? Unlikely.

It's also important to note that whilst many of the positive solutions above are delivered on mobile devices, we are still in the early days of understanding the negative impact of these devices in our lives. There are concerns that these very same mobile devices can be responsible for problems with mental health and impaired well-being, for example the excessive use of social media leading to poor mental health. We need to understand how best to minimise potential harm and maximise benefits for any apps we choose to explore.

In these challenging times, it's easy to despair. Instead, let's keep supporting, exploring, pushing, and trying. Through our actions, we inspire others to do the same. ✱

■ *Dr Amanda Salter is Associate Director at Akasaa, a boutique content development firm. Based in Newbury, UK, she has delivered award-winning global customer experience (CX) strategies and been a practitioner of Agile for over a decade. Her recent guest lecture at the University of Cambridge shared insights on architecting impactful CX. Dr Salter holds a PhD in Human Centred Web Design; BSc (Hons) Computing Science, First Class; and is a certified member of the UK Market Research Society and Association for Qualitative Research.*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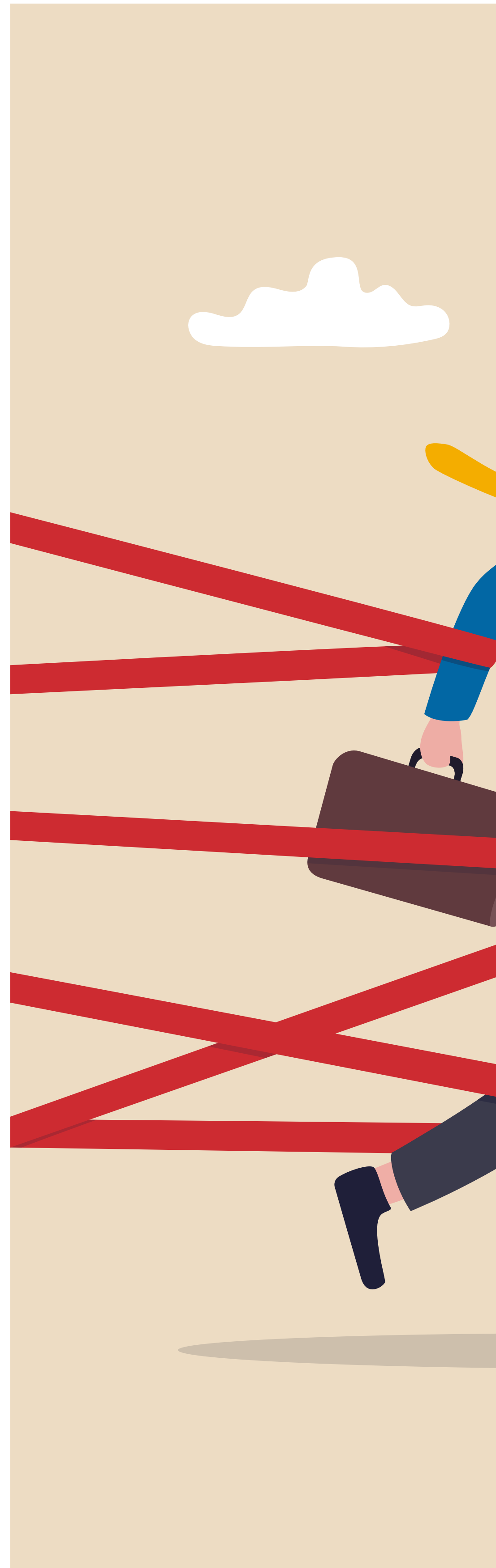


FREEDOM WITHIN THE FRAMEWORK: THE COMPETITIVE ADVANTAGE IN A CHANGING WORLD

By Crystal Cha

Freedom and discipline need not be at odds with each other.

When discussing freedom and structure within organisations, the two concepts are often seen as polar opposites at odds with each other. Common wisdom holds that small companies can allow autonomy and flexibility but grow more rigid as they scale. For managers trying to strike a balance between what is often seen as opposites, it can feel like a choice between the lesser of two evils: a 'Wild West' type of freedom or a bureaucratic hellhole from a *Dilbert* comic strip.

But freedom and control aren't necessarily opposites; they can work hand in hand within a framework that provides structure without being suffocating. Dr Thun Thamrongnawasawat, Professor of Practice at the Asia School of Business and prolific leadership author, teaches us how trust and autonomy can enable agility and innovation, how to balance freedom and good governance, and how leaders and managers should rethink the way they manage their people, using the approach called Freedom Within the Framework.

THE VALUE OF FREEDOM IN A PANDEMIC-AFFECTED BUSINESS ENVIRONMENT

"More than ever, autonomy is a big motivating factor for the current workforce, especially for the younger generation. Increasingly, it is not money that is driving them to quit their jobs, but having the freedom and choice of what to do and how to do it," said Dr Thun, who has worked with over 100 global companies on strategy, leading change, training, and executive coaching, and specialises in the neuroscience of leadership, with MSc and PhD degrees from the University of Illinois at Urbana-Champaign.

Dr Thun started his career at Boston Consulting Group, before holding a series of management positions in multinationals and eventually devoting his career to his passion of empowering leaders using what is known about the brain, giving him tremendous experience to draw upon when it comes to the science of management.

"People want the autonomy and agency to be able to create change and do things in the way they see fit. Even for those who don't quit employment to start their own businesses, they may seek out opportunities in the corporate world where they are treated as an intrapreneur," he added.

Covid-19 has made the increase in autonomy at work even more apparent. More employees than ever are working from home, away from their usual oversight, rules, processes, and in-person interactions. "There are both pull and push factors contributing to the increased need for autonomy and being able to trust your people," said Dr Thun. "The pull factor is that employees want this. The push factor is that Covid-19 has forced this upon management teams."

Science backs the value of giving workers greater trust and freedom, as Daniel Pink's 2009 *New York Times* bestseller, *Drive*, highlights, drawing from research including an MIT study. Pink argues that traditional 'carrot and stick' approaches to management are insufficient to meet the needs of today's

Covid-19 has made the increase in autonomy at work even more apparent. **MORE EMPLOYEES THAN EVER ARE WORKING FROM HOME,** away from their usual oversight, rules, processes, and in-person interactions.

economy which require businesses to be innovative, creative, and agile. Successful modern workplaces cultivate intrinsic motivation among employees, underpinned by three key components: Autonomy, Mastery, and Purpose.

FREEDOM THROUGH DISCIPLINE

But the benefits of autonomy don't come from letting people do whatever they want. "Ironically, it is the companies who are the most disciplined that reap the most benefits of entrusting their employees with freedom," he argues. "Take Netflix, for example. They got rid of their expense policy and replaced it with a short, simple statement: Act in Netflix's best interest. But they could do this because they were fanatical and extremely disciplined about their culture and had an extensive culture handbook."

"Another company closer to home that I can think of is EPF (Employees Provident Fund) Malaysia, which has implemented staggered working hours, telecommuting options, and a flexible benefits programme to enable staff to easily strike a balance between work and their personal lives," added Dr Thun. For EPF, the key was to enable freedom in the form of flexibility, without compromising on outcomes or key performance indicators. The company reports that since implementing its work-life practices, productivity has increased, along with winning them TalentCorp's Life at Work Awards 2018 in the Best Public Sector Organisation, CEO Champion and Outstanding Practice (Workplace) categories.

"Another company closer to home that I can think of is EPF (Employees Provident Fund) Malaysia, which has implemented staggered working hours, telecommuting options, and a flexible benefits programme to enable staff to easily strike a **BALANCE BETWEEN WORK AND THEIR PERSONAL LIVES**."

So how much freedom can you give your people while avoiding unnecessary risks, and how do you ensure that, like at Netflix, your team will 'act in the company's best interest'? Conversely, how can you know if working constraints are too tight, leading to a lack of trust and agility?

THE KEY TO FREEDOM WITHIN A FRAMEWORK: ALIGNMENT OF VALUES AND PURPOSE

Dr Thun explains that before managers can determine how much freedom to give to their team, they need to understand and map out their values and those of their team. Next, it's important to understand which ones overlap and which ones don't, to "avoid the landmines", as Dr Thun puts it. The final step is honing in on the sweet spot – or the overlap in common values and purpose that both parties share. (See **Figure 1**)

"Without this map, you might unintentionally step on a landmine – something another person values because it's not something you value. You might be caught off guard, wondering why this person is suddenly acting difficult and uncooperative," said Dr Thun.

"There are many ways this model can be applied – between individuals or groups of people," said Dr Thun as he shared a story of how he applied this model:

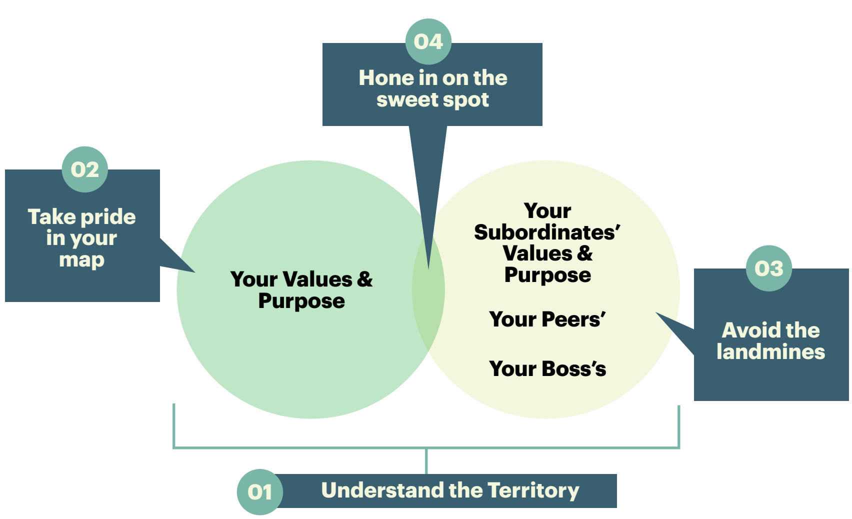
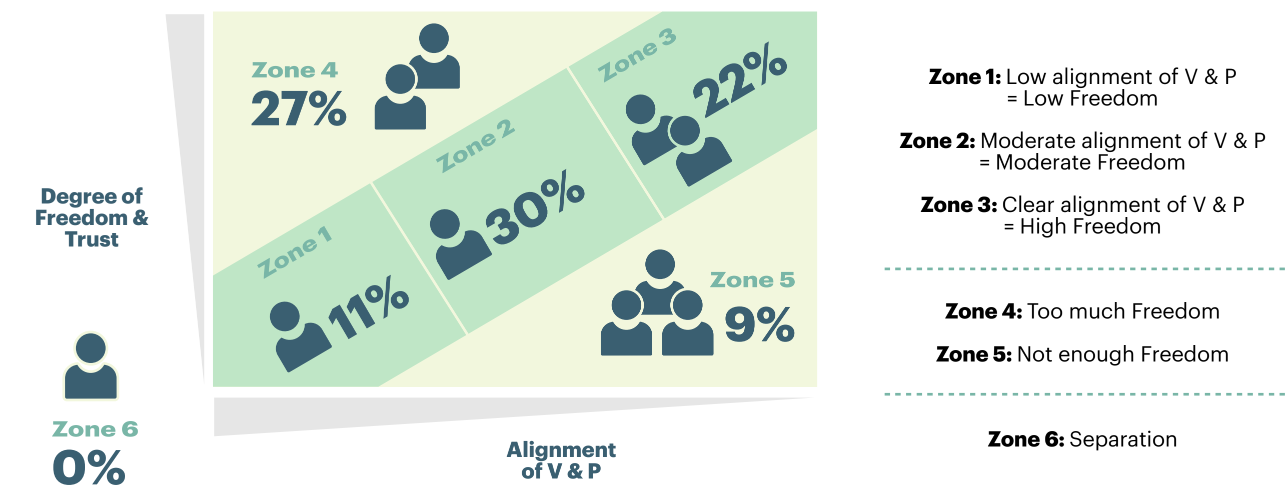


Figure 1: Values & Purpose Alignment (UTAH Model).
Source: Freedom Within The Framework, Thun Thamrongnawasawat.

"A fellow colleague and I were tasked with running a leadership programme and we were making a decision about whether to host this programme in person or online, given the current Covid-19 situation. We thought that because we had limited the number of participants and would be able to adhere to social distancing protocols, we could safely proceed with running it in person. Our boss was very concerned about this

Figure 2: Where are the Members of My Team? (Plot out where each team member is currently located).
Source: Michael Kossler & Thun Thamrongnawasawat.



approach. After some discussion, we recognised that the main value driving our boss' concern was the participants' safety and well-being. We could find common ground in wanting to ensure people's safety. So, we decided to run the programme but go a step further – we required all participants to take a swab test before joining us, even though it was not mandatory."

THE SIX ZONES OF FREEDOM WITHIN THE FRAMEWORK

After a clear map has been made of the team and individuals' values and purpose, what comes next? This is where the alignment of values and purpose is plotted on a horizontal axis, while the degree of freedom employees have is plotted on a vertical axis. This forms the framework developed by Dr Thun together with Michael Kossler.

"While the concept of 'freedom within a framework' has been talked about for a long time, it wasn't until we put this graph together that managers had a tangible tool to help them map out their framework," explained Dr Thun.

To use the framework, managers identify where each team member stands in terms of alignment, and how much freedom each one currently has. Anything outside Zones 1 to 3 (see **Figure 2**) is suboptimal.

"Zone 4 employees are being given unearned freedom. These are the people who will cause you headaches. When there is too much freedom, smart people can do bad things. It's not only one's skillset that must be aligned with the job; the heart must be aligned with the company's values."

Meanwhile, Zone 5 employees are those with the capacity to perform at a higher level, but have their hands tied behind their backs. "With too little freedom, they stop being invested, start coasting by, and they don't give you extra effort. They will probably start looking for a new job and that's where they enter Zone 6 – separation."

The key is to get employees outside the blue zones into those zones, by either reducing or increasing the amount of freedom given. For employees in Zones 1 and 2, the key is to work on increasing alignment, so that freedom can gradually be increased as well.

AVOIDING LANDMINES AND BUILDING RESILIENCY

One of the practical considerations with implementing Freedom Within a Framework is that it should be done on multiple levels to see where the overlaps are at an organisational, team, departmental, and individual level. And mapping it out is only the beginning.

"For this to be effective, people must talk about it. The hidden must be made visible. Groups must be brought together or it won't take long before people start stepping on each other's landmines and talking behind each other's backs. Trigger points are aplenty – finding common ground requires intentionality," said Dr Thun. Beyond the workplace, he even uses this approach with his kids and spouse to build alignment through connecting on common values.

In today's fast-changing world, alignment is more critical than ever to survive, adapt, and thrive. "Rules and governance are prescriptive. In light of Covid-19, it's clearer than ever that we cannot fully know everything that will happen and prepare for all scenarios," said Dr Thun.

"Instead of governing through rigid dos and don'ts, organisations can build greater resiliency, agility, and adaptability by giving people a framework to work freely within, guided by common values and shared purpose." ✱

■ *Crystal Cha is Assistant Director, Content Marketing at Asia School of Business. She holds an MBA and BA (Hons) in Multimedia Journalism.*

WEB 3.0: SHOULD YOU CARE?

By Kannan Agarwal

WHAT IT IS, WHAT IT COULD BE, WHY IT MATTERS.

In the 1990s, less than 1% of the global population had access to the internet. Today, that figure has leapt to 59.5%, equivalent to 4.66 billion people, with 92.6% of them accessing it via their mobile devices, according to Statista.

This ever-growing digital footprint has resulted in an unprecedented number of breach-of-privacy scandals – Cambridge Analytica, LinkedIn, Equifax, to name a few. Unsurprisingly, McKinsey & Co's recent survey of American consumers found that more than 50% of consumers do not trust the companies and brands they patronise – including financial institutions – to protect their private data. Other perception surveys around the world point to the same.

It is no wonder that many are now opting to either deactivate their social media user accounts in attempts to reduce their digital footprints or move towards an upcoming third generation of the internet known as Web 3.0, in order to protect their data from the companies who access and may even be profiting from it.

So, what exactly is Web 3.0?

BOOMS & BUSTS

Although inventors like Nikola Tesla had visions of a "world wireless system" as early as the 1900s, it wasn't until the 1980s, when British computer scientist Tim Berners-Lee invented the world wide web (or 'www' as we know it today) that the online world manifested into something tangible, comprehensible, and useful for the everyday man.

This early version is considered Web 1.0, static websites where data is accessible online and information is pushed to users; no interaction, no engagement. Browsers like Netscape and MSN contained millions of 'read only' websites that were built for the sole purpose of sharing information with a large audience, an information superhighway that was a massive collection of content oligopolised by phone companies and cable networks. Millennials today will snicker looking at an old-school Yahoo browser with word-only search capabilities (a far cry from Google Lens and other interactive features that are commonplace today), but back then, the notion that you could get information any time, any day while sitting at your desk was nothing short of revolutionary. It led to a frenzy of interest and speculative investing in all internet-based businesses, which eventually resulted in the dotcom crash in 2000.

With millions of investors having crashed and burned in that encounter, interest in the internet waned. It was only around 2007, when the next disruption of the internet went mainstream and the tech sector started getting hot again. This is Web 2.0, a transition from basic read/write functions to social networks; the internet was abuzz and became the place for people to virtually gather, interact, and collaborate. The exponential rise in blogs, online fora, private chatrooms, wikis became *de rigeur*.

By today's standards, if you don't have a social network footprint on one of the main social media platforms – Facebook, Google, LinkedIn, Twitter, YouTube,

Pinterest, Instagram, Tik Tok – your social currency goes down and for many, it means you just don't exist.

Businesses have jumped onto the bandwagon and benefited from its collaborative nature: near-instant communication, direct exchange with customers, increased efficiency through process automation embedded on these social platforms, and the rise of social influencers who work with brands to drive sales for products and services.

However, this disruption has its downside. Web 2.0 has resulted in the rise of a new breed of oligopolists – Big Tech corporations like Facebook, Amazon, Google that hold inordinate power over the private user data. Such digital information concentrated in the hands of a few technology platforms have given rise to scandals and hacks with far-reaching consequences. Loss of privacy,

For the growing number of individuals who have been hacked, spammed, or victims of identity theft, the answer is a clear 'no'. In 2018, it was **REPORTED THAT 44% OF USERS AGED 18 TO 29 DELETED THE FACEBOOK APP** from their phones and 54% adjusted their privacy settings, in a poll by Pew Research.

control over personal information, biased search algorithms – are these worthwhile trade-offs for the sake of greater connectivity and convenience?

For the growing number of individuals who have been hacked, spammed, or victims of identity theft, the answer is a clear 'no'. In 2018, it was reported that 44% of users aged 18 to 29 deleted the Facebook app from their phones and 54% adjusted their privacy settings, in a poll by Pew Research. That figure has undoubtedly increased over the years and users switch off or tune out from social media platforms.

Enter Web 3.0, also known as the spatial web or metaverse. In this next-gen model of the internet, power shifts from Big Tech to individual users in decentralised, aggregated models. Some have described it as the 'read/write/own' phase where users manage and operate

FRONT OF THE PACK

Many business leaders may get the impression that this evolution (Web 3.0) is too far off to warrant attention. However, there are important actions to be taken today to prepare for, benefit from, and shape this new era as it unfolds. While the best entry points may vary by industry segment, the following actions will be beneficial for most:

- **BUILD WITH THE FUTURE IN MIND.** Most large companies have already started working with many of the technologies enabling the spatial web, but often they aren't building with that end-state in mind. This can cause them to miss valuable efficiencies. For example, start looking for ways to streamline and connect 3D assets.

- **EXPERIMENT WITH IoT AND LOCATION-BASED SENSORS.** Tapping into sensor data enables a business' operational awareness, which, in turn, can yield optimised operations. Learning to manage data from sensors – whether from camera feeds, trackers on trucks, or infusion pump sensors in hospitals – helps prepare the business for handling the volume of data and also helps them begin to benefit from the insights they can provide. An increasing variety of sensors will become key inputs for spatial web users.

- **MAP OUT YOUR BUSINESS.** Whether it's modelling large facilities for wayfinding, having a digital twin of your brick-and-mortar store shelves and inventory, creating geographical models to optimise logistics, or creating a digital twin of the manufacturing line, it's going to become increasingly important to have a digital representation of your business and the location of its elements. This helps to lay the groundwork for monitoring and optimising by using its digital equivalent.

- **INSIST ON INTEROPERABLE, ETHICAL STANDARDS.** The spatial web is a convergence of emerging technologies. Both established and new organisations are already starting to establish standards to enable interoperability across applications. These organisations and the resulting standards efforts can be strengthened by support from the business community. Jan-Erik Vinje of Open AR Cloud group urges, "Now is the time to get that perspective...and also speak about the way we think about this future and what values should be the north star when making this technology, if we want to make it benefit as many people as possible and be a good engine of economic growth and technological and societal development."

Source: *The Spatial Web and Web 3.0*, Deloitte.

data on their own terms, wresting back power from tech corporations.

In a Deloitte report, *The Spatial Web and Web 3.0: What Business Leaders Should Know About the Next Era of Computing*, the consulting firm writes that it is "for leaders to understand what this next era of computing entails, how it could transform businesses, and how it can create new value as it unfolds".

"It is the next evolution in computing and information technology, on the same trajectory that began with Web 1.0 and our current Web 2.0. We are now seeing the spatial web unfold, which will eventually eliminate the boundary between digital content and physical objects that we know today. We call it 'spatial' because digital information will exist in space, integrated and inseparable from the physical world.

"This vision will be realised through the growth and convergence of enabling technologies, including augmented and virtual reality (AR/VR), advanced networking (e.g. 5G), geolocation, IoT (Internet of Things) devices and sensors, distributed ledger technology (e.g. blockchain), and artificial intelligence/machine learning (AI/ML). While estimates predict the full realisation of the spatial web may be 5–10 years away, many early-stage applications are already driving significant competitive advantage."

If this sounds a little out of this world, that's because in many ways it still is. Even seasoned tech savants like Elon Musk, Co-founder and CEO of Tesla and SpaceX who revolutionised car and space travel, has gone on the record to say "I currently am unable to see a compelling metaverse situation" and that Web 3.0 is "more marketing than reality". His voice is chief in the chorus of notable tech visionaries tempering the hype that others are keen to whip up.

Musk's cryptic comments highlight the frivolity of many use-cases and the disappointing experiences that currently dominate the metaverse discussion: "Sure you can put a TV on your nose, but I'm not sure that makes you 'in the metaverse'. I don't see someone strapping a frigging screen to their face all day and not wanting to ever leave. That seems…no way."

With the pace of technological change today though, regulators are not leaving

Web 2.0	Web 3.0
Characteristics • User created and controlled content • Sharing of information and ideas through social media • A more participatory web experience	**Characteristics** • Semantic search and understanding • AI/ML • Blockchain technology • Real-time data processing • The rise of voice search • Decentralised privacy & security • IoT • Augmented & virtual reality • 3D
Tools • Blogs and Wikis • Social bookmarking and RSS (really simple syndication) feeds • Podcasting	**Tools** • Semantic web • Personal data management • Augmentation • Cloud computing
Platforms facebook, YouTube, twitter, WordPress, LinkedIn, tumblr, Pinterest, Wikipedia	**Platforms** steemit, brave, Ethlance, status

Figure 1: Adapted from *The Evolution of Web 2.0 to Web 3.0.*
Source: Medium.com

By decentralising key aspects of financial infrastructure, such as **ACCESS, DATA, AND CODE, OPEN CRYPTO NETWORKS CAN ALSO POTENTIALLY ENHANCE INCLUSION AND INNOVATION.** When firms of all sizes, and even individuals, can directly access financial infrastructure, it could mean more competition and inclusion.

much to chance and already discussing what a democratised internet could mean for decentralised finance – the distributed ledger technology underpinning cryptocurrencies like bitcoin and ethereum – or DeFi for short.

In his panel remarks about *Decentralised Finance and the Future of Money* delivered at the Andrew Crockett Memorial Lecture via livestream in June 2021, Ravi Menon, Managing Director at the Monetary Authority of Singapore, notes how central banks and regulators can shape DeFi by incorporating Web 3.0 as part of an ever-growing fintech strategy that will uphold financial resilience and stability:

"Technology is enabling a fundamentally different approach to financial infrastructure, compared to the centralised systems of today. Take, for example, open crypto networks based on self-executing smart contracts and non-custodial financial services, where users maintain control over their assets at all times. By replacing intermediaries and central parties, these networks aim to reduce both the cost and risk of finance."

"By decentralising key aspects of financial infrastructure, such as access, data, and code, open crypto networks can also potentially enhance inclusion and innovation. When firms of all sizes, and even individuals, can directly access financial infrastructure, it could mean more competition and inclusion. When transaction data is available to all participants, and not confined within the intermediary responsible for the transaction as is the case today, it could mean more contestability and transparency. When code can run directly and publicly on these networks, unlike proprietary code that runs on private servers, it could mean more interoperability and innovation.

Although his comments are specific to DeFi, the approach can be applied to almost all other aspects of governing the metaverse. However, like Musk says, the metaverse is still far off from being deployed in everyday life in droves. Even though it is not the place of regulators to pre-empt innovation in markets, they are aware that they must be in sync with the latest tech in order to supervise its development and guide where necessary.

Menon acknowledges the opportunities as well as challenges that Web 3.0 poses, and is already concerned with next-gen infrastructure in finance: "We are certainly not at the point where these self-governing networks can meet the high standards of governance, security, resilience that we demand of critical infrastructure. Even so, central banks would do well to incorporate these innovations in designing the next generation of payment infrastructure." ✱

■ *Kannan Agarwal is a Singapore-based researcher with Akasaa, a boutique content development firm with presence in Malaysia, Singapore, and the UK.*

EXPONENTIAL THINKING:
FUTURE PRINCIPLES TO REDESIGN OUR BRAIN'S OPERATING SYSTEM

By Derek Ariss

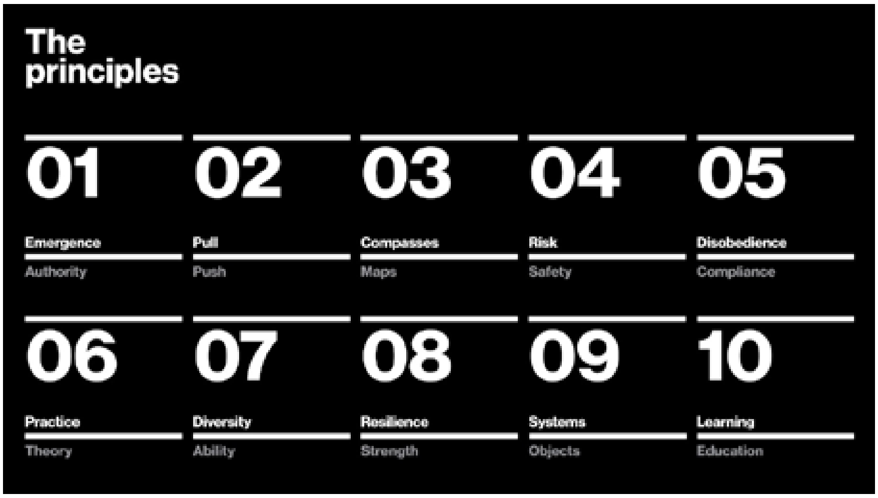
Experiment, stay open-minded, be flexible.

Welcome to a period in the world when things are getting extremely interesting. Times are changing and, for most of us, the skills that we have developed in the past are not the skills that we will need to navigate our way forward into the future.

For example, many of us will remember a time, perhaps only one generation ago, when you could go to school, graduate, look for a job, and eventually get employment. If you worked hard, you would keep that position for the rest of your work life. Even with changes, most of us had significant moments of stability. Today, having a good education is still very useful; however, finding a job for a lifetime is almost impossible. More importantly, the chances are high that your present work situation will last only about 48 months. Career changes will happen regularly and more frequently. Pre-Covid, it was estimated the average person today would change jobs over 12 times throughout their career.

Life is very different now than a few years ago, mainly due to technology. Thanks to technology driving change so quickly, a lot of the past patterns can't be used as a projection of where we will be in the future. Courtesy of technology, information is available to everyone who has access to the web. Due to this, people, if they choose, can make great strides forward in all areas of life, be they commercial or personal. Technology has also been shifting and changing the area of financial services. In finance, technology drives multiple organisational structures from past centralised structures to now become decentralised structures, e.g. Traditional centralised financial models are now being shifted to decentralised finance models. Technology impacts our currencies and storage of value, where digital currency formats are constantly hitting the headlines of current news topics ranging from digital dollars to NFTs (non-fungible tokens).

In finance, technology drives multiple organisational structures from past centralised structures to now become decentralised structures, e.g. Traditional centralised financial models are now being shifted to decentralised finance models. **TECHNOLOGY IMPACTS OUR CURRENCIES AND STORAGE OF VALUE,** where digital currency formats are constantly hitting the headlines of current news topics ranging from digital dollars to NFTs (non-fungible tokens).



SOURCE: Aron Fay from Pentagram for Whiplash.

But where do we look for a new mental operating system? Where might we find such a new way of thinking? I believe that part of the answer is in a book, **WHIPLASH: HOW TO SURVIVE OUR FASTER FUTURE**, by Joi Ito and Jeff Howe.

The big question is, "How do we cope in the continuously altering, decentralised world in which we live?". The past way of thinking and doing things may not have the answer. It's as if our thought processes, our 'operating systems' need an upgrade. But where do we look for a new mental operating system? Where might we find such a new way of thinking? I believe that part of the answer is in a book, *Whiplash: How to Survive our Faster Future*, by Joi Ito and Jeff Howe.

Whiplash shares ten principles that can be used to survive and adapt to the technological changes shaping our future. The book is a thought provoker and can be used as a guide. Ito is former director of the MIT Media Lab and Howe is an experienced journalist from *WIRED* magazine. As a team, they create a thought piece that is worth referencing.

I want to discuss three of the 10 principles in this article, which resonate particularly well.

The principles are:
practice over theory
learning over education
resilience over strength

PRACTICE OVER THEORY

The principle of practice over theory is about recognising that in a fast-paced, technology-driven future, where change is now the new constant, there is often a higher cost to waiting and planning than doing and improvising.

As Albert Einstein stated, "In theory, there is no difference between theory and practice. In practice, there is". Side note: Interestingly, there is debate as to who this quote originated from; some people credit the famous baseball player Yogi Berra, others Albert Einstein, and still others Richard P Feynman. Regardless of its origins, this quote is in good stead and a helpful reminder of this impactful principle.

The main idea is to understand that we learn better and faster when we build things and do them versus spend too much time and plan them out. Our knowledge and experiences make the learning objective and practical as we build.

For example, have you ever noticed that a plan or idea in your mind always goes well, but when it comes to delivering on the plan, things often go different than expected? A simple one-day task frequently takes several days and is always more complicated and expensive than anticipated.

As an illustration highlighting the

dramatic difference between theory and practice, I want you to imagine feeding three puppies out of three bowls that are in a row. You may have imagined that each puppy would go to its separate bowl and quietly eat its meal. In reality that never happens – there is always one bowl that looks better than the rest which all three puppies will fight over and voila "Puppy Mayhem" and bowls of food all over the kitchen. The difference between practice and theory.

You may have planned for the puppies eat from the bowls that are nicely lined up, but when you try it in practice, it just won't happen that way!

To deliver faster and better, Ito and Howe emphasise less planning and more doing. Traditionally, products and services were created, which required detailed plans and oversight before production of the product or service could begin.

Their suggested approach is to use methods similar to what was created with Agile software development. Using Agile methodology means focusing on adaptive planning and on-the-spot improvisation to address unexpected challenges. The benefits of this approach are that the practice of collaboration and experimentation are reinforced and that teams learn by doing. A win-win strategy is created for both the organisation and individual with active learning.

Their suggested approach is to use methods similar to what was created with Agile software development. **USING AGILE METHODOLOGY MEANS FOCUSING ON ADAPTIVE PLANNING AND ON-THE-SPOT IMPROVISATION** to address unexpected challenges. The benefits of this approach are that the practice of collaboration and experimentation are reinforced and that teams learn by doing.

For a brief on Agile culture and a deeper understanding of how practice-over-theory works, there is an excellent video entitled *Spotify Engineering Culture - Part 1.* You develop a clear sense of how software development teams apply this principle. You can start thinking about how this can be directly used in financial services, not just software development.

LEARNING OVER EDUCATION

The second principle from *Whiplash* is learning over education.

For most of us are learning stops when we graduate and wave goodbye to our last educational institution. So, we then have at least 50 to 60 years of our lives left. To succeed and move forward, we have to find a better way to keep learning and, more importantly, apply the learning.

As Ito says, "Education is what people do to you, and learning is what you do to yourself." This is a powerful distinction.

The learning-over-education principle highlights that a major shift is necessary in gathering and using knowledge. Firstly, instead of using the traditional top-down, one-way model of knowledge transfer, the future of learning needs to be an active connected system where participants are taught how to learn better and apply what they have learned immediately.

This means that learning needs to become interactive and applicable. Ideally,

participants who actively learn will walk away from a programme and immediately practice and apply what they learned in order to create impact.

Participants must go out of their way to apply what they've learned.

Education may stop once you receive some form of accreditation; however, learning never stops. Success in the future is reliant upon continuous learning. Learning and applying such learning directly in the work environment will lead to successful, more fulfilled employees and productive, engaging organisations.

We all have a responsibility to ourselves to keep learning, growing and applying our knowledge throughout all of our lives. As a reminder of this message, I recall that in early 2019, pre-Covid, I attended a conference at the National University of Singapore. There, Senior Minister of State for Education Chee Hong Tat emphasised that we as individuals need to embrace lifelong learning to remain relevant. It is possible to do, however we all need to do this more.

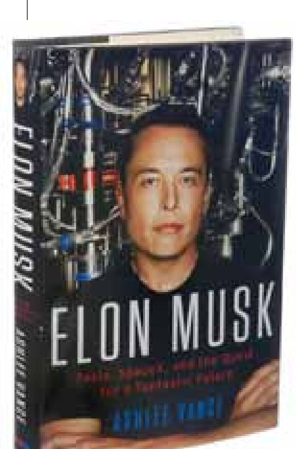
The winners, it seems, will be the people who apply this learning. We all need to apply our learnings over our lifetimes.

When emulating the education-over-learning principle, an ideal role model for us to consider is Elon Musk. As the story goes, Elon completed a bachelor of arts in economics and a bachelor of science in physics at the University of Pennsylvania and then attended Stanford University to pursue business studies. While attending Stanford, he decided instead to pursue a business career. He actively used what he was learning and applied it in software development, then banking. From there, he became the Founder, CEO, and Chief Engineer at Space X, early-stage investor CEO and Product Architect of Tesla Inc, Founder of the Boring Company, and Co-founder of Neuralink and Open AI.

Each year, thousands of students graduate with the same educational background and programming experience as Elon Musk. How many of them are applying their knowledge actively? Part of the key to success could be the active application of this knowledge and the continuous learning that goes with this experience.

Source: depositphotos.com

When emulating the education-over-learning principle, **AN IDEAL ROLE MODEL FOR US TO CONSIDER IS ELON MUSK**. As the story goes, Elon completed a bachelor of arts in economics and a bachelor of science in physics at the University of Pennsylvania and then attended Stanford University to pursue business studies. While attending Stanford, he decided instead to pursue a business career.



Interestingly, with the principle of learning over education, even though technology has allowed affordable access to knowledge, people still need to develop an active interest in what they have learned and commit to learning and applying knowledge.

RESILIENCE OVER STRENGTH

The third principle we will discuss is the concept of resilience over strength. An excellent way to illustrate this principle is to consider the qualities of a bough versus an oak tree. When strong winds blow, the supple bough bends with the wind, never breaking; however, the strong oak tree breaks and fragments with a strong enough wind.

It's a similar principle when studying at large organisations. Historically, most large organisations, as Ito puts it, "hardened themselves against failure." They have hierarchical management structures, rigid processes, and detailed multiple-year plans to grow and develop.

As environments change, so does fintech. However, with this ever-altering future, environments are moving too quickly. To survive, many fintech companies have taken a very different approach. Since fintech structures are often new, untested, and to deal


Source: depositphotos.com

with continuous change, they need an enormous appetite to take on risks and stay limber.

When it comes to staying flexible, I look to the example of Alipay. As you may be aware Alipay is a mobile payment platform launched in China in 2004 by Chinese e-commerce giant Alibaba. It is an e-wallet downloadable on mobile devices. Taobao, the e-commerce platform of Alibaba, needed an escrow service acting between the buyer and the seller, withholding the payment until the buyer receives the purchased goods. Alipay was born to power e-commerce transactions.

Today, Alipay has evolved into a huge financial ecosystem: Huabei wealth management platform Ant Fortune, private online bank MYbank, credit scoring and loyalty programme system Zhima Credit. But to get to this level of success, it had to stay limber and flexible.

A great story illustrates how flexible Alipay needed to be to make it to where it is now. As Alibaba developed its payment platform for mobiles, it ran into a problem. It needed software that all mobile phones could use to connect customers to their payment system. The issue was that each mobile phone manufacturer had manufacturer-specific software, which meant that Alibaba would have to create specific software for each manufacturer,

There needed to be a better solution and the solution was to use the mobile phone's **CAMERA TO IDENTIFY CODES. MORE SPECIFICALLY THEY CHOSE TO USE, QUICK RESPONSE CODES OR QR CODES, WHICH WERE ORIGINALLY DEVELOPED BY MASAHIRO HARA FOR TOYOTA IN 1994.** The QR code allowed Alipay to pioneer mobile payments in China, and the rest is history. Being flexible rather than being strong made all the difference.

and then enter into complex contracts to allow that software to be installed. There had to be a better way, and there was.

Instead of solving the issue using software, the team looked at what was similar in all mobile phones. It was not the software but the hardware that was consistent. All phones had microphones, receivers, and cameras. So Alibaba embarked on creating a 'sound wave payment technology' to transmit payments.

Unfortunately, the sound wave technology was a not reliable solution for completing payments. There needed to be a better solution and the solution was to use the mobile phone's camera to identify codes. More specifically they chose to use, Quick Response codes or QR codes, which were originally developed by Masahiro Hara for Toyota in 1994. The QR code allowed Alipay to pioneer mobile payments in China, and the rest is history. Being flexible rather than being strong made all the difference.

In this fast-paced, technology-driven, constantly changing world, we need to see the world and address challenges differently in order to stay successful.

In this article, we've discussed three principles which I feel is important for all of us to embrace. Applying this information, regularly experimenting, and staying open-minded and flexible is a great start.

Interested? Please read at *Whiplash* and see the other seven principles. It will be time well spent. ✱

■ *Derek Ariss is Head of Innovation Education at Lightbulb Capital and is responsible for building the education practice, focusing on creativity, design thinking, technology, culture, and mindset conducive to innovation in finance. Derek also teaches part of the Singapore Management University (SMU) Certificate in FinTech and Innovation course and an Innovation Culture Catalyst course at SMU. He holds an MBA in International Marketing and Strategy and Bachelor of Commerce (Hons) from the University of Windsor, Canada, and a Bachelor of Science in Psychology and Biology.*

SPACs: ALL THAT GLITTERS MAY NOT BE GOLD

By Chartered Banker Institute, UK

WILL SPECIAL PURPOSE ACQUISITION COMPANIES STILL BE MAKING HEADLINES DURING 2022, AND ARE INVESTORS REALLY WRITING THEM A BLANK CHEQUE?

For the unfamiliar, a special purpose acquisition company (SPAC) is a form of 'cash shell' investment vehicle that raises funds from investors at an initial public offering (IPO) for the primary purpose of taking over an existing company. Typically, the target company is unlisted, hence merging with a listed SPAC presents opportunities both for the SPAC investors to enter the private equity space, and for the target company to go public without the regulatory hassle of conducting its own IPO.

The target company, however, is usually undetermined and universally undisclosed at the time of IPO. In essence, investors in a SPAC IPO do so without knowledge of which company they will ultimately be invested in – they are often said to be handing over a 'blank cheque'.

For example, at the time of Digital World Acquisition Corp's IPO in August 2021, investors were unaware that the SPAC could become a vehicle to take Donald Trump's Trump Media & Technology Group public, under controversial plans announced just weeks later.

While SPACs are not new, their popularity and prevalence have surged during the pandemic. In 2020 and 2021, respectively, 248 and 613 SPACs were floated on US exchanges, raising a total of USD83.4 billion and USD162.5 billion from investors. This compares with 59 SPAC listings during 2019, raising GBP13.6 billion in total – itself a more than decade-long high, according to data from *spacinsider.com.*

I predict that SPACs will continue to make headlines in 2022, not least because, following a slowdown in mid-2021, SPAC activity appears to be gearing up again. In addition, as time begins to run out for SPACs formed at the start of this wave, the value delivered to investors through SPAC deals will attract keen scrutiny.

SAFEGUARDS IN PLACE

At face value, the SPAC concept is strikingly alike the opportunity described in the following cautionary anecdote. Famously, it is said that an 18th century promoter "absurdly" and "preposterously" lured irrationally credulous investors of 1720 London, during the South Sea Bubble period, to invest in "a company for carrying on an undertaking of great advantage, but nobody to know what it is" (Mackay, 1841).

However, reassuringly, modern SPACs feature several safeguards which can, in principle, reduce investors' exposure to downside risk. Above all else, the IPO proceeds are held in a trust account until a merger is conducted. If the SPAC fails to identify a merger target within a pre-defined period (usually two years), it is liquidated, with the balance of the trust account returned to shareholders, normally gross of fees.

Even if a merger opportunity is identified, and a majority of SPAC shareholders vote to approve the transaction, each shareholder still has the chance to redeem their share capital from trust. Alternatively, they can sell their shares at the market price if that is higher. On the flip side, an investor who wishes to remain invested post-merger may gain additional exposure to upside potential through warrants,

including those often gifted as 'incentives' during the merger deliberations.

Given this, it may not, on reflection, be entirely fair to say that investors in SPAC IPOs are handing over a 'blank cheque', or at least not one that is signed and ready to cash in. It seems more analogous, in practice, to a refundable deposit. The investment terms at IPO are sufficiently attractive that many hedge funds, colloquially known as the 'SPAC mafia', are heavy investors. With names such as Glazer Capital and Goldman Sachs among those listed by M Gahng, JR Ritter and D Zhang (2021) as the largest investors in SPACs, one is not necessarily left with an impression of the typical SPAC investor as one that is naïve.

That said, there are still several unguarded risks for the SPAC investor, principally that there is little recourse for those who opt to go along with a merger that winds up being rotten. For all that is said about the SPAC mafia's keenness to invest in IPOs, less often noted is their tendency to exit before the 'de-SPAC', or post-merger, period.

MERGER INCENTIVES AND COMPETITION

Two points raised above may become especially prescient during 2022. First, that the amount of capital raised by SPACs surged to unprecedented levels from mid-2020. Second, that SPAC managers typically face a two-year deadline to identify and acquire a willing target company, or else the funds are returned to shareholders. Particularly for those who formed SPACs early on in the current wave, the clock is ticking.

Focusing just on the US, there were 861 SPACs listed during 2020 and 2021 combined. At the time of writing (January 2022), less than a quarter (181) had completed deals, although a further 108 had announced potential mergers. The majority of the SPACs formed during the 'boom' period of the past two years are still courting.

Due to the vast amount of SPAC capital now chasing deals, there is a real danger that a shortage of investible companies that are attracted to going public via the SPAC route will drive fierce competition for good-quality targets. This may result in a race to the bottom, reduced standards, and aggressive efforts to persuade and push deals through, even if against shareholder interests.

This is because the sponsors that set up SPACs do not typically charge management fees, but instead are compensated through a 20% stake in the SPAC's shares, coupled with warrants, neither of which pay off in the event of liquidation. The economic incentives of SPAC sponsors are therefore to complete any deal, rather than have no deal at all.

Historically, SPACs that successfully complete mergers have gone on to severely underperform the market, on average, during the post-merger (de-SPAC) period (Dimitrova, 2017), suggesting that this concern is not unsubstantial.

In addition to competition for good-quality merger targets, we may also see SPACs competing more fiercely for new investors willing to buy into the mergers proposed. It is a misnomer to think that SPACs necessarily bring an entirely deal-ready pool of capital (i.e. that 'blank cheque'). Often, substantial numbers of SPAC shareholders choose to pull out at the merger stage, in many cases necessitating new fundraising rounds to make up the shortfall.

SPACs have raised eyebrows over the past two years due to eye-watering amounts of capital raised at IPO. However, that, in many senses, is the easy part. SPAC success is constrained mainly by the availability of good-quality companies to merge with, and investors that are willing to stick around for the de-SPAC period, not by their ability to raise capital at IPO. Thus, high volumes of the latter may give more reason to be wary than impressed. While it suggests that SPAC sponsors feel better able to close good deals now than before the pandemic, much of this fervour remains to be proven. Let us hope that naïve de-SPAC investors do not wind up bearing the costs of excess exuberance. ✱

■ *This article by Dr Danial Hemmings of Bangor Business School, previously appeared in the Chartered Banker magazine, UK, Spring 2022 edition.*

BRAND LOYALTY HAS A NEW METRIC

By Julia Chong

Does the NPS move over for the new kid in town?

In 1993, Fred Reichheld introduced the concept of the Net Promoter Score (NPS) in his book, *Loyalty Rules! How Today's Leaders Build Lasting Relationships,* a work that has since been credited with putting loyalty economics on the map of business management.

Since then, the NPS has entered mainstream lexicon and is one of the few metrics relied on by organisations to measure customer experience (CX) and determine brand loyalty, aspects which, in turn, bear down on growth figures. The simplicity of the NPS made it hugely popular and today it is unquestioningly (or blindly) incorporated into every customer survey platform.

The research was simple. Thousands of customers in six industries were sent a series of 20 questions, an acid test to gauge loyalty. The results showed that one question stood out with the highest correlation as to whether a customer would be a detractor or promoter of the business. That question is: On a scale of one to 10, how likely is it that you would recommend this company to a friend or colleague?

GETTING TO THE NPS

Respondents fall into three categories:

DETRACTORS

0 1 2 3 4 5 6

PASSIVES

7 8

PROMOTERS

9 10

NPS = % OF PROMOTERS - % OF DETRACTORS

DETRACTORS ARE CUSTOMERS WHO GIVE A SCORE OF ZERO TO SIX

indicating a dissatisfaction with the company. They are more likely to discourage friends or colleagues from using its product and services.

PASSIVES ARE CUSTOMERS WHO GIVE A SCORE OF EITHER SEVEN OR EIGHT

indicating that they are not likely to actively recommend the company to others.

PROMOTERS ARE CUSTOMERS WHO GIVE A SCORE OF NINE OR 10

and are likely to actively recommend the company to others.

Then take the percentage of promoters and subtract the percentage of detractors. This will generate a score ranging from -100 to 100, which is the NPS. A positive NPS means that you have more people recommending the company or product organically than people discouraging others from the company, while a negative score means the opposite.

Sources: Adapted from Zendesk, Survey Monkey.

However, after three decades, the cracks in the NPS are evident not only to legit practitioners in the CX sphere, but the creator himself who has spoken out against the abuse and misuse of the metric. Reichheld states that two-thirds of Fortune 1,000 companies report the NPS yet only 5% derive its full benefits. Here's why:

+ Companies started using NPS as a metric to justify bonuses. Whilst this doesn't seem like a red flag, employees started finding ways to game the system. These tactics have been subject of much research, including Rob Markey's *Harvard Business Review* article, *The Dangers of Linking Pay to Customer Feedback,* in which he writes: "With incentive compensation, you get exactly – and only – what you pay for. Once compensation depends on improving a particular score, people tend to focus on the metric rather than on what it tells you about what customers want or need."

Linking the NPS to remuneration incentivises poor behaviour, skewing employee goals from "what does the customer want or need?" to "how do I score higher?". This happens in many ways: employees would nudge customers on the survey at the end of the call with "rate me a 10 if you like my service"; managers warn that "if there's any reason why you won't rate me a 10, please let me know before giving feedback"; and customer service would only poll nice customers in easy-to-solve cases.

+ Declaring NPS in annual reports without an auditable or comparable process. Many multinationals declare the NPS as part of their annual report, a misleading move as it creates the impression that the NPS is of a standard comparable to financial figures governed by Generally Accepted Accounting Principles (GAAP) rules and financial reporting regulations. It is not. Many companies have deviated from the standard response scale and formulation of questions, whilst others diverge too much from the official standard NPS question. Far from being an industry benchmark for delightful customer service, its gaps in the data collection process make the NPS unsuitable for any benchmarking exercise.

+ Customers lose faith when they don't see follow through. When the NPS is executed as a standalone metric or is not embedded as part of a product roadmap to enhance customer experience, the entire exercise fails to elevate the brand or transform into meaningful change.

Given these drawbacks, Reichheld's article in the December 2021 issue of *Harvard Business Review* marked the coming of a new metric, the earned growth rate (EGR), in which he and his co-authors set out to correct the drawbacks of the NPS by developing "a complementary metric that drew on accounting results".

In *Net Promoter 3.0,* Reichheld et al outline "a better system for understanding the real value of happy customers" through calculation of the EGR, which has two building blocks:

#1 Net revenue retention (NRR): This statistic is used in several industries, most notably in software-as-a-service. Once you have organised revenues by customer, you can determine your NRR. Simply tally this year's revenue from customers who were with you last year, divide that amount by last year's total revenue, and express that figure as a percentage.

#2 Earned new customers (ENC): This is the percentage of spending from new customers you've earned through referrals (as opposed to bought through promotional channels). This component will take a bit more effort because firms must ascertain why new customers have come on board. While it may require some experimentation and refinement, ENC is important to track. The sooner you have a reasonable estimate of revenues from ENC, you can better focus your customer acquisition investments — and justify more investment in delighting current customers. Firms today undervalue referrals. They treat them as icing on the cake rather than an essential (perhaps *the most* essential) ingredient for sustainable growth.

Once these two elements are in place, apply these into the calculation:

EGR = (NRR + ENC) – 100%

The creators also state that the EGR complements the NPS. Their book, *Winning on Purpose: The Unbeatable Strategy of Loving Customers,* details the intricacies of deriving the individual statistics of the NRR and ENC, and how to interpret the EGR results on standalone basis as well as in tandem with the NPS.

Given the current technical challenges and information asymmetry that come with implementing the EGR, it is too soon to determine whether corporations take to it the way they did with the NPS. It is proof that brand loyalty and CX are moving the way of 'hard science' and it bears reminding that there are no silver-bullet metrics in any science. ✱

In the several months since the concept of earned growth was introduced to quantify loyalty-based growth, companies and consultants have dived in to ask important questions of how it will impact their respective customer journeys and frameworks.

This includes market research firm Forrester, whose latest blog post, *Earned Growth: A Boon Even for Companies That Cannot Implement the Metric,* analyses the EGR's implications, which is summarised below:

ADVANTAGES

CUSTOMER-BASED ACCOUNTING IS THE NIRVANA FOR CX PROS TRYING TO PROVE RETURN-ON-INVESTMENT.

To calculate earned growth, firms must use 'customer-based accounting' – tracking of revenues, cost to serve, etc, for each customer. CX practitioners have been desperate for this data and emphasis on EGR would help them link experience quality to business-relevant behaviour for each customer.

EARNED GROWTH FORCES A DISCUSSION OF HOW A COMPANY WANTS TO WIN CUSTOMERS.

The metric requires stakeholders to define a new customer as either 'earned' (those who buy after they hear about the great experience from other customers) or 'bought' (join because of a marketing campaign or discount). That discussion alone is valuable and forces an acknowledgement that too many companies spend a lot of money in acquiring new customers who aren't profitable in the long run. This gets particularly interesting for companies with trapped customers who must do business with the firm — think utilities or other monopolies. These firms might end up making the bold call to classify any new customer as bought!

A GROWING SHARE OF SUBSCRIPTION-BASED FIRMS MAKE NRR CALCULATIONS MORE COMMON.

NRR calculations work best with recurring revenue business models in industries where contracts are the norm. It is thus encouraging that the number of businesses that operate such subscription models is growing, making the NRR data more readily available.

DISADVANTAGES

MANY COMPANIES WILL STRUGGLE TO GATHER THE DATA THEY NEED TO CALCULATE EARNED GROWTH.

Firms will struggle, especially in industries where purchases are infrequent or contracts aren't common, e.g. retail, travel, or automotive. While the authors argue that the hurdles to calculating earned growth aren't bigger than those for other metrics required by GAAP, the complexity of calculating it may become a serious deterrent for brands.

CLASSIFYING CUSTOMERS AS EITHER 'EARNED' OR 'BOUGHT' IS SIMPLISTIC.

Firstly, new customers come to businesses for many reasons, e.g. business-to-business buyers go through an average of 27 interactions (salespeople, third parties, material, etc) before they buy — a mix of 'earned' and 'bought' interactions. Secondly, differentiating between 'earned' and 'bought' customers glosses over the fact that part of the revenue from a new customer might be bought while another may be earned. For example, a new utility customer might be considered bought (since she doesn't have a choice), but if she decides to add a smart meter because of a great onboarding experience, that would be earned revenue from a bought customer.

ASKING CUSTOMERS WHY THEY CAME CAN CREATE MISLEADING DATA.

Not all customers want to answer why they became a customer and willing customers may mislead firms unconsciously. Customers aren't always aware why they make decisions and like to think they made rational ones rather than reacting to an ad. This underestimates the impact of being marketed to and overestimates the impact of recommendations.

ADVANTAGES

REGULATORS MIGHT FEEL COMPELLED TO STANDARDISE A METRIC FOR LOYALTY-BASED GROWTH.

Reichheld et al call on regulators to make earned growth a “formal GAAP metric with precise reporting rules”. If a customer-loyalty-based metric became a required and standardised metric, that would put loyalty studies on the big stage.

CALCULATING EARNED GROWTH WILL ENCOURAGE COLLABORATION BETWEEN CX AND ACCOUNTING PROS.

The chief financial officer (CFO) is a powerful ally to help CX practitioners. It can convince others to focus on CX by adding financial grit and narrative. If CFOs are to report earned growth, they are more likely to collaborate with CX and customer insights specialists as they will want to learn about customer loyalty and its drivers to ensure they can create the right forecast and understand how to move the metric.

DISADVANTAGES

A UNIFIED, STANDARDISED CLASSIFICATION OF CUSTOMERS AS ‘EARNED’ OR ‘BOUGHT’ DOESN’T EXIST YET.

To determine whether a customer is bought or earned, the authors suggest asking each new customer why they came to the company. They present a few response options. For example, customers who select “trustworthy reputation” or “recommendation from friends” are considered earned; whilst those who select “helpful salesperson”, “advertisement”, or “special deal” are considered bought. The authors acknowledge the need to “develop a universally applicable process”, otherwise the data will vary a lot by company and not be comparable. Any company using answer options must pre-test them with customers in order to avoid confusion or ambiguity.

EARNED GROWTH SHARES THE INDUSTRY-SPECIFIC CHALLENGES OF NPS.

In industries where the clients have very limited choices — think cable companies, utilities, or professional insurance — asking a customer why she started buying from the firm is awkward at best and tone-deaf at worst, and counting their continued revenue as loyalty is painting the wrong picture of earned growth.

EARNED GROWTH CAN SET UP THE ORGANISATION FOR CONFLICT RATHER THAN COLLABORATION.

Closer collaboration between sales, marketing, product, and CX can lead to better outcomes, and companies may spend valuable time arguing over who should get credit for an earned customer and who should not. That time would be better spent on working together to make customers happy and loyal.

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