

# banking insight

PP 17327/05/2013(032407)

AN EXCLUSIVE INTERVIEW WITH  
**TAN SRI AZMAN HASHIM**  
CHAIRMAN, AICB  
REIMAGINING BANKS THROUGH  
ETHICS & PROBITY

The Importance of Effective  
Corporate Governance

By William Coen  
Secretary-General

Basel Committee on Banking Supervision  
Bank for International Settlements

## BREAKING BAD BEHAVIOUR: RESHAPING BANKING'S ETHOS

Recent findings indicate there's still some way to go in regaining public trust. Can recent strides to rein in misconduct help banks make the quantum leap?



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## Editor's Note

# VALUES, VIRTUE AND VALIANCE: KEYS TO GOOD BEHAVIOUR

### TEN YEARS ON AFTER SUBPRIME SCANDALS

triggered a global financial crisis, the aftermath of pain and systemic shock still lingers. Unsurprisingly, banks and financial institutions remain under scrutiny; despite compliance with stricter and more voluminous regulations, the behaviour of many prime institutions hogging news headlines indicates that the punitive lessons against self-serving greed and short-term satisfaction versus long-term sustainability were not fully imbibed.

The Asian Institute of Chartered Bankers places intense emphasis on embedding ethical behaviour, values and standards of professionalism among bankers and institutions in the banking sector, in order to revitalise public trust for a sector that has been reviled and vilified for bad behaviour. As such, it is timely that this issue of *Banking Insight* focuses on the sector's efforts to break bad habits and reshape the ethos of banking in a more ethical and sustainable mode. Apart from taking a helicopter view of banks' behaviour and culture post-crisis, *Banking Insight* zooms in on regulators' efforts to enhance good governance and the sector's own initiatives to change their culture and DNA to encourage boards, management and employees to embody desired and upstanding values. We shine the spotlight on the drivers behind banking misconduct and how regulators and banks are implementing appropriate guidelines and safeguards to better manage banking conduct risk. At a more granular level, we also look at how banks are conducting employee screening and due diligence to spot the bad apples which spoil the barrel and expose institutions to reputational risk, and how the appointment of an independent and empowered CRO is directly linked to mitigating risks and driving shareholder value.

As always, *Banking Insight* strives to cover developments emerging in the frontiers of banking to keep our members updated as part of our commitment to continuing professional education. Check out how fintech is being mobilised to improve microfinance and financial inclusion solutions and create better outcomes for the unbanked and underbanked. Cryptocurrencies and blockchain are topics *du jour*; central banks are experimenting with the possibility of launching central bank-issued digital currency, which could overcome current problems with regulating independent non-fiat cryptocurrencies and stimulate greater acceptance of digital payments. Plus, find out how banks are applying blockchain technologies to potentially revolutionise KYC and eliminate duplication of work, data tampering and, most significantly, reduce compliance turnaround, resources and costs.

While new is tantalising, the wisdom of hindsight offers substantial lessons, such as those shared by Tan Sri Azman Hashim, a stalwart icon of the banking industry and champion of financial inclusion for social good in an exclusive interview with *Banking Insight*. With more than fifty years' experience in business and governance, Tan Sri Azman's most pertinent message is that institutions must innovate, while becoming more ethical and customer- and stakeholder-centric to achieve longevity and sustainability.

Tan Sri Azman echoes other leaders calling for systemic and genuine change, driven by valiance, virtue and values at the institutional and individual levels. As BoE Governor Mark Carney said in a February 2013 speech in Ontario, "Virtue cannot be regulated. Even the strongest supervision cannot guarantee good conduct. Essential will be the rediscovery of core values... living the right values will be the most important challenge." Ten years on, have bankers instilled the changes necessary to reclaim public trust and rebuild tattered reputations? The jury is still out, but banks' behaviour shows that we still have far to go to live up to the standards expected of us by the public and other stakeholders. ✱

*Hope you have a fruitful read.*

The Editor

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**PRINTER**

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► **FRONTIER-ECONOMY BANKS TAKE CENTRESTAGE**

The performance of Cambodian and Vietnamese banks stood out in The Banker's 2016 Top 100 Association of Southeast Asian Nations (ASEAN) Banks ranking.

Although only two Cambodian banks – Aceda Bank (up 17 spots to No. 71) and Canadia Bank (debut at No. 94) – made the Top 100, the country's banking sector outpaced the region across the board in Tier 1 capital growth, total asset growth and pre-tax profits.

Bucking the trend in ASEAN jurisdictions, Cambodian and Vietnamese lenders registered year-on-year (y-o-y) pre-tax gains of 25.54% and 8.7% respectively.

The two countries also led the tables with total asset growth of 23.03% and 13.36% respectively. Y-o-y aggregate Tier 1 capital growth in 2015, from which the banks are ranked, saw Cambodian banks securing top spot at 25.23% and Vietnamese banks at third place with 8.07%, behind Indonesia which clocked an increase of 9.36%. \*

# FINTECH HACKS

Bank Negara Malaysia's Financial Technology Enabler Group (FTEG) launched its 'Fintech Hacks' initiative to actively engage with consumers to contribute ideas and improve the delivery of technology-based financial services in Malaysia.



The FTEG, established in 2016 to formulate and enhance regulatory policies for greater adoption of fintech in Malaysia, aims to identify pain points and aggregate public feedback to support innovations that will improve the quality, efficiency and accessibility of financial services in Malaysia via its website and using the social media hashtag #fintechhacks. \*



**28%** of CIOs and CSOs reported security compromises of mobile devices in 2016. **SECURING SMARTPHONES** is the No. 1 spending priority for authentication in 2017. – PwC 'Global State of Information Security® Survey 2017'.

**USD678.5 BILLION OR AN 8.9% increase** in 1Q2017 total deal value of global mergers & acquisitions (M&A) versus 1Q2016. Technology will drive M&A activity, with disruptive industries such as artificial intelligence, fintech and the Internet of things continuing to attract investor attention. – Katharine Dennys, EMEA research editor at Mergermarket.



## GENDER MYTH BUSTER

Boston Consulting Group's latest research report, *Dispelling the Myths of the Gender "Ambition Gap,"* demolishes the myth that age and motherhood compel women to lower their career goals. Instead, the global survey comprising 200,000+ respondents, presents data to support findings that women's ambition levels vary based on corporate culture; when a positive corporate culture and attitude regarding gender diversity is cultivated, all women (including mothers) are eager to advance. Highlights from the report:

- **Ambition** is influenced by company culture. When both male and female employees feel that gender diversity at their organisation is improving, there is no ambition gap between genders.
- **Women** start their careers with as much ambition as men - or more.
- **Having children** does not make women less ambitious.

The firm recommends structural changes such as flexible work and building a gender-diverse leadership to promote greater participation and retention of women. \*





**DATA MANAGEMENT IN THE RISK WORLD CAN BE OVERWHELMING. HERE ARE GUIDELINES ON HOW BANKS SHOULD TACKLE THE MOST COMMON CHALLENGES EN ROUTE TO BECOMING A DATA-DRIVEN ORGANISATION.**

## ways to combat data management hurdles

Firms have acknowledged the need for a strong data management practice and although much has been done to usher banks into a new era of data-driven reporting, many are drowning in a sea of information overload and under pressure to report speedily with high-quality data.

New standards such as IFRS 9 Financial Instrument, Basel Committee on Banking Supervision regulation No. 239 (BCBS 239) Principles for Effective Risk Data Aggregation and Risk Reporting; and processes such as recovery and resolution planning, and stress testing; and ad hoc requests by regulators, have directed the type and granularity of information banks must now collate as well as its management. Current risk management practices are far from sufficient to meet increasing regulatory demands.

Risk reporting today extends beyond traditional financial risk metrics. As risk information starts to shed light onto the management and performance of firms, the concomitant requirement and disclosure to senior management and regulators on other business-related information becomes crucial for assessment and business decision-making. Beyond regulator-driven standards



for improved governance, consistency and integrity, it is crucial that banks themselves understand how a transformation in its data mining architecture can unlock real business value.

Below are ways in which banks can overcome common hurdles and institute in its place a good data compliance programme:

#### 1 Active data quality management.

A critical component of good data compliance is managing data quality. The saying 'rubbish in, rubbish out' rings true in every sense in this perspective. Erroneous data renders even the most sophisticated of systems and models pointless. Cleaning up data is a necessary effort to which banks must commit time and effort. Eliminating inefficiencies through data reconciliation, patching of information and re-checking contributes significantly to the ability of firms to generate the required results and analysis with both accuracy and speed. A common pain point is the crunch of reporting season, as inconsistencies and off-the-mark results are generated as a consequence of poor data and/or incomplete information, resulting in gaps in the data stream. Simple features such as rule-based error messages, background checks, and periodic data tests should be performed to continuously resolve any data issues arising. More important is to have in place continuous process improvement to ensure good data quality can be achieved.

2 Standardised data. This is a forward-thinking move that calls for subject matter experts with a thorough understanding of data requirements throughout banks' back-, middle- and front-office functions in order to achieve a consistent definition of data sets. From format irregularities, varying definitions and competing system architectures, these issues become tenuous to align but are necessary. Many banks find that various reconciliations need to be performed when information is extracted from multiple sources, thus compromising data integrity. By adopting financial technology or outsourcing data reconciliation tasks, banks can begin



5 Data transparency. Any model developed should be made editable under the right governance process, instead of being hosted in a black box that is not visible to anyone or locked away for future refinement. Financial risk or financial models are critical information for banks, in particular the risk management function. The understanding of inputs and sources of information to the respective models are as important as having the right data.

to break down the silo operations to converge risk, finance, operations and business data.

3 Strive for a single source of information. Be it a single data mart for data extraction, analysis and reporting or maintaining multiple systems that are linked to a robust risk analytics engine, information should be accessible and leveraged from one system to another. Achieving this also enables higher efficiency. For example, in analysing a customer's credit risk profile, most banks typically maintain identity information in its customer management system, repayment behaviour and data in a separate credit management system while the credit risk team hosts a separate set of information which may be linked to the accounting general ledger system but not to the overarching credit risk management system (CRMS). The gap may occur where certain information that is maintained in the CRMS, could be an input in the credit risk profiling, but is not available in the credit risk system, thereby requiring either a separate manual feed, resulting in potential data integrity issues. Should a consistent definition be employed and a flow-through of information be maintained from a single source, a single point of entry in one system could feed the data for various purposes, thereby achieving efficiency, consistency and optimisation.

4 Understanding sources and drivers of risk. This is essential in order to understand the risk tolerance levels and therefore risk appetite of the firm as risk

information is increasingly crucial in the development of business strategy. The response to questions such as: "What are the risk adjusted returns of a business? How much capital is being used? Is there sufficient liquid asset to withstand illiquidity should a financial crisis occur? Is there sufficient capital coverage for high-risk asset growth? Is this where we should strategically take the business?" need to be revisited periodically to create a robust data reporting that responds in step with fast-changing business environments.

6 System flexibility. While many banks work towards maintaining a risk data mart to house all risk-related information, focus must be accorded to the ever-expanding universe of risk data. As regulatory requirements such as BCBS 239 suggest, the required reporting covers risk and non-risk data, therefore the definition of risk data will continuously evolve with the change in regulatory requirement. Banks need to consider the flexibility built into their risk tools and systems to respond to current as well as future risk environments.

The transformation of banks into data-driven organisations requires significant planning in terms of infrastructure investment and talent acquisition. The payoff is flexibility, agility and accuracy in its response to evolving changes in the risk world.\*

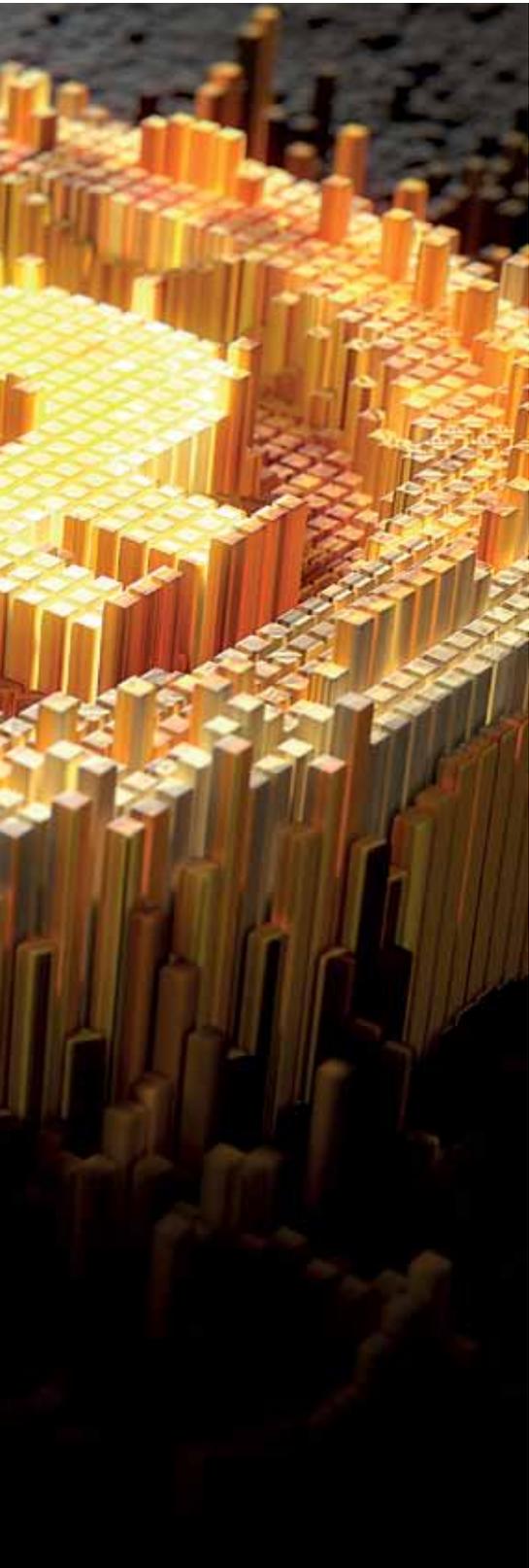
■ Reporting by the Banking Insight Editorial Team.



# How Blockchain

## IS SHAPING KYC'S FUTURE

Described as one of the **most enabling and disruptive technologies** thus far, distributed ledger technology is set to revolutionise identity information exchange and client onboarding.



As global vigilance to detect and prevent financial crime hits an all-time high, so too has the cost of compliance at financial institutions (FIs). On 28 May 2015, the *Financial Times* reported that additional outlay for this at some banks totalled up to USD4 billion annually and senior management is under increasing pressure to rein this in.

In the hopes of restoring bottom line numbers, FIs are now leveraging on the power of blockchains. Accenture's latest 17 January 2017 report, *Banking on Blockchain: A Value Analysis for Investment Banks*, projected that the technology could potentially reduce infrastructure cost at the world's top eight investment banks between USD8-12 billion annually by 2025.

The disruptive nature of blockchains or distributed ledger technology in capital markets, part of the Big Data revolution sweeping the finance sector, is deployed in various forms, from validating cryptocurrency transactions to enabling smart contracts. Where the technology is still nascent is its application in the Know Your Client (KYC) compliance sphere.

#### **BLOCKCHAIN 101**

A blockchain is a shared digital ledger of interconnected computers that records all transactions in a public or private network. Each validated transaction by members of the network is permanently recorded in the ledger in blocks, and each block is linked to form a chain from the very earliest to the most current hence the term 'blockchain', which is the technology at the heart of distributed ledgers.

The efficiency of a blockchain is multifold. Using distributed ledger technology, members of the blockchain can share sensitive data more securely as other members are only allowed to view transactions relevant to them, thus adhering to personal data protection laws whilst the blockchain continuously culls and updates data into a golden source of identity information. Its decentralised means of aggregating and verifying information – the *raison d'être* of blockchain is the absence of any 'central authority' to vet or approve information – prevents any one participant or groups of participants from compromising the integrity of the system or output.

This level of encrypted security is achieved through several features which, theoretically, give distributed ledger technology its advantage over existing KYC information registries:



**+ The disruptive nature of blockchains or distributed ledger technology in capital markets, part of the Big Data revolution sweeping the finance sector, is deployed in various forms, from validating cryptocurrency transactions to enabling smart contracts.**

In light of this, many see the underlying potential of blockchain technology to revolutionise KYC and do for it what its done for payments, settlements and smart contracts – eliminating duplication of work, data tampering and, most significantly, to bring compliance turnaround and costs down to acceptable levels.

> **Consensus protocol**

This is the essential feature which keeps the blockchain or distributed ledger system working even if one or several members fail to function. Maintained by a network of computers or nodes, members – state actors, financial institutions, corporations – agree on a set of rules and procedures in order to be part of this shared golden source of information with no centralised authority in charge.

> **Cryptographic hashes**

Applied algorithms ensure that any alteration to input data can be traced back to its source, raising a ‘red flag’ through use of an assigned identifier to indicate to members that the input data has been altered and may potentially be compromised data.

> **Digital signatures:**

Private assigned keys ensure tracking to a single source is possible and the transactions originated from the sender and not an imposter.

The above are the basics behind existing blockchain/distributed ledger systems containing transactional data for settlements and payments.

In light of this, many see the underlying potential of blockchain technology to revolutionise KYC and do for it what its done for payments, settlements and smart contracts – eliminating duplication of work, data tampering and, most significantly, to bring compliance turnaround and costs down to acceptable levels.

**BREAKING INFORMATION SILOS**

Accurate and timely KYC reporting are the foundations of a strong anti-money laundering and counter financing of terrorism (AML/CFT) programme, and in recent years, numerous KYC solutions



have come to the fore, including SWIFT's KYC Registry, one of the industry's largest with over 3,500 banks globally. However, these existing solutions have not significantly solved the biggest issues plaguing the industry – shortfalls in accuracy and timeliness.

The jointly-produced Dow Jones–Association of Certified AML Specialists' *2016 Global Anti-Money Laundering Survey* reported that in adopting technology-based solutions, 47% of compliance officers cited excessive false positives as one of its top concerns; 14% reported timeliness as another crucial issue affecting confidence in client-screening data accuracy, prompting them to review their existing solutions. This indicates that although most banks have turned to Software-as-a-Service (SaaS) firms to manage aspects of KYC compliance, none have been wholly successful in unlocking true value.

On top of this, each FI stores its AML information in organisational silos behind confidential



**+ But things are changing. Blockchain-enabled distributed ledgers are currently being tested to address the twin problems of accuracy and timeliness in customer due diligence (CDD) investigations.**

In a bit of ‘Wisdom of Crowds’ philosophy, the progenitors of blockchain see it as more than just shared data – it is shared control, but unlike the simple aggregation of transaction data, applying blockchain technology in compliance is a far more complicated and risky affair.

information barriers, spurring the need for centralised intermediaries/agencies to gain efficiencies across the market, none of which are currently based on the blockchain/distributed ledger technology.

But things are changing. Blockchain-enabled distributed ledgers are currently being tested to address the twin problems of accuracy and timeliness in customer due diligence (CDD) investigations.

#### **UNLOCKING VALUE**

On 10 November 2016, the proof-of-concept for a KYC registry was announced comprising 10 major banks and the New York-based R3 blockchain consortium, a research and development group of over 70 global FIs. Over three months, using data simulated on R3’s Corda platform, participants created and managed both individual and legal entities with relevant documentation. Members used distributed ledger technology to simulate onboarding procedures fulfilling KYC requirements on a single, unified interface, demonstrating the technology’s potential to streamline and simplify compliance monitoring and reporting.

More recently, the National Stock Exchange of India, the nation’s biggest stock exchange, together with five other FI players trialled the country’s first KYC blockchain collaboration using a platform provided by financial technology start-up Elemental.

Through these collaborations, software developers and banks seek automation and increase operational efficiency in KYC compliance through:

##### **> Identity management**

Every FI performing the KYC process would share its validated information and documents by uploading to a central registry, tagging each

customer to a commonly agreed unique identification number such as a Legal Entity Identifier (LEI) which are now common in Europe but have yet to gain ground in Asia. This digitised warehouse of information – which includes data such as source of funding, shareholding, credit history, politically exposed persons, progress updates – can be accessed by other members in the network in order to perform its own CDD.

##### **> Reductions in cost, duplication of work**

According to Thomson Reuters’ Cost of Compliance 2016 report, over 33% of firms spend at least a day each week tracking and analysing regulatory change. Automated execution of KYC/AML investigations combining the analysis of both internal and external data sources would lower enterprise-wide operational compliance costs as well as overall headcount.

##### **> Enhanced security**

Higher data integrity through identity encryption, allowing banks to scan customer documents and generating private assigned keys to seal the information before sending it to the blockchain. Only authorised entities with the private assigned keys can thus view the information, giving members the convenience of a centralised database without having to relinquish power to a third party.

##### **> Transparent, near real-time updates**

Once the document is uploaded to a distributed ledger system, it is almost instantaneously available to other members.

##### **> Historical overview**

The ledger would be the most comprehensive source containing all shared documents and compliance

activities conducted on any one client, which also works to justify to regulators that the bank has complied with existing onboarding regulations as well as detect any potential AML/CFT activity upon annual account review.

These efficiencies would shave precious time and cost, allowing banks to reallocate resources from compliance to its core business of lending.

#### **CRACKING THE CODE**

Adoption of blockchain in KYC also opens up possibilities of integration with other blockchain applications currently used in settlements, payments and smart contracts. This could signify the next level of interoperability merging compliance, transactions and operations. For instance, using integrated blockchains, banks could automatically permit contract settlements for clients who turn up negative KYC checks.

In a bit of ‘Wisdom of Crowds’ philosophy, the progenitors of blockchain see it as more than just shared data – it is shared control, but unlike the simple aggregation of transaction data, applying blockchain technology in compliance is a far more complicated and risky affair.

If done right, SaaS firms that crack the code can expect immense returns and FI players may finally see a scalable method to significantly control compliance costs. ✱

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