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banking insight

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EXCLUSIVE INTERVIEW WITH TAN SRI TAY AH LEK
FELLOW CHARTERED BANKER
RETURN TO A RELATIONSHIP OF TRUST

RISKS OF 'DE-RISKING'

Regulating Fintech: Undoing the Gordian Knot

COUNTDOWN TO MiFID II

How extraterritorial is the new regulation for Asia-Pacific?

RISK UNDER REVIEW

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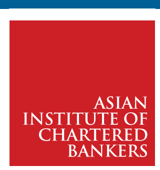

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Emerging Asia

TIPS GLOBAL UPSWING

Better-than-expected 1H2017 growth figures clocked in emerging Asia – China, India, and the five ASEAN countries Indonesia, Malaysia, the Philippines, Thailand and Vietnam – contributed to the upward revision in projected global growth, the International Monetary Fund wrote in its October *World Economic Outlook* report.

The fund published a 0.1 percentage point increase for both its 2017 and 2018 projections, bringing growth to 3.6% and 3.7% respectively since its previous April tally.

Other contributing factors were broad-based revisions clocked in the eurozone, Japan, emerging Europe and Russia which more than offset downward revisions in the US and UK. Overall, recovery in many countries remain weak with these risks:

- Rapid and sizeable tightening of global financial conditions.
- Financial turmoil in emerging market economies.
- Persistently low inflation in advanced economies.
- A broad rollback of improvements in financial regulation and oversight achieved since the global financial crisis.
- An inward shift toward protectionist policies.
- Non-economic shocks including geopolitical and domestic tensions, weak governance, extreme weather and terrorism concerns. ✱

'LEAVE NO ONE BEHIND'

UN Women recommends shifts in macroeconomic policies to advance the financial inclusion of women. Its discussion paper 'Macroeconomic Policy and Women's Economic Empowerment' advocates that policymakers meet Agenda 2030's 'leave no one behind' goal by:

Looking beyond growth and broadening the definition of macroeconomic goals beyond fiscal and monetary policy to include women's economic empowerment.

Using monetary policy to channel credit to marginalised women.

Removing gender bias in policymaking.

Expanding fiscal space via key investments in infrastructure for the working poor.

Strengthening women's voice and participation in macroeconomic decision-making through informal economy budgeting and gender-responsive budgeting. ✱

Only 23% of surveyed **COMPANIES HAVE EFFECTIVELY INTEGRATED RISK AND FINANCE FUNCTIONS;** 43% expect closer coordinating within two years. This pattern was also evidenced in the 2015 study, indicating this ambition is difficult to achieve.

– Accenture 2017 Global Risk Management Study 'Exposed: The Hidden Value of Risk'.

It is important to guarantee a level playing field, not to look for only ostensible national advantages. The US [is] expected to adhere to the agreements concluded and committed. Against this background, the proposed US deregulatory measures regarding capital and liquidity rules are questionable.

Andreas Dombret
Head of the Department of Banking and Financial Supervision at Deutsche Bundesbank, in an American Banker interview.

RETURN TO A **Relationship of Trust**

IN AN EXCLUSIVE INTERVIEW, **FELLOW CHARTERED BANKER TAN SRI TAY AH LEK, MANAGING DIRECTOR AND CHIEF EXECUTIVE OFFICER AT PUBLIC BANK BHD AND ASIAN INSTITUTE OF CHARTERED BANKERS COUNCIL MEMBER,** DELVES INTO WHY PROFESSIONALISING BANKING IS A CALL FOR THE INDUSTRY TO RETURN TO ITS ROOTS.

Q As a Fellow Chartered Banker with over 56 years of experience in Asian banking and finance, how has the conduct and culture of banking evolved? Why is professionalism of the industry mission critical in today's banking landscape?

The banking landscape in the region has evolved tremendously over the decades. A bank's role has advanced from basic financial intermediation to more sophisticated service and product offerings in line with the growing demands of society.

With a growing middle class and an increasingly educated and urbanised population, the customers I faced back in my early days in banking are drastically different than from the customers that bankers face these days. The business community has also seen rapid transformation since the early 1960s – small local companies to the birth of more multinational conglomerates; from companies participating in a largely commodity-based economy to the booming industrial and manufacturing sector in the last decades of

 | BY ANGELA YAP

How extraterritorial is the new regulation for Asia-Pacific?

Countdown to MiFID II

As you read this, financial firms throughout the Asia-Pacific (APAC) region are bracing themselves for the 3 January 2018 launch of the European Union's (EU) overhaul of trading rules.

The Markets in Financial Instruments Directive II (MiFID II Directive) and Markets in Financial Instruments Regulations (MiFIR), which together form MiFID II, present an unprecedented wave of compliance changes throughout the lifecycle of bonds, stocks, commodities and derivatives trading. Whilst MiFIR's effect is directly binding on all EU members, MiFID II governs transposition into national law.

Devised to increase investor protection since the introduction of MiFID I in November 2008, the latest iteration of expanded rules will now – in addition to equities trading on regulated platforms – apply to equity-like and non-equity instruments on all trading platforms including multilateral trading facility (MTF) or organised trading facility (OTF). Systematic internalisers (SIs) are not technically considered trading venues but are counterparties to a transaction and bound by MiFID II provisions.

Its impact on APAC is by way of export compliance. All APAC banks, sell-side and buy-side firms that trade within the EU, service EU-based client or subcontract on behalf of EU-based MiFID II-regulated entities must adhere to the new EU standards and mandates upon go-live.

+The end game of MiFID II is to promote greater confidence in trading through enhanced transparency measures. Additionally, buy-side firms may potentially become price makers as data on volume, price and liquidity become more easily available.

The end game of MiFID II is to promote greater confidence in trading through enhanced transparency measures. Additionally, buy-side firms may potentially become price makers as data on volume, price and liquidity become more easily available.

STATE OF PLAY

Before examining the APAC impact, it's necessary to take stock of Europe's current position on the regulations, including taxonomies in understanding the evolution of this regime.

FINANCIAL GLOBALISATION
FAR FROM 'PEAK FINANCE'

Economic indicators point to evolution of financial globalisation – one that is more inclusive, stable and led by developing markets.

The motto for one of the world's leading financial newspaper is "We live in Financial Times." True, but what of it?

Ten years since the global financial crisis (GFC), the financial landscape has oscillated from a 'lighter-touch' regime to greater regulation and, most recently, signs are surfacing that it may swing yet again to the former with talks of deregulating Wall Street.

However, new quantitative research show that the nature of global financial integration has evolved since 2007 to one that is more deeply connected, stable and diverse. It also refutes recent claims by economists that the world has reached "peak finance" – the thesis that the world has experienced the peak of global finance and is on its way towards financial deglobalisation.

ZEITGEIST

In analysing the effects of globalisation, we distinguish between two types of integration: The cross-border flow of goods and services – termed 'real integration' – as distinct from that which arises out of financial flows, known as 'financial integration'.

The distinction is vital. While academicians have near-consensus that the net effect of 'real integration' is positive for all participant countries, the jury is still out on the benefits of 'financial integration'.

Nobel Laureate and former

Ten years since the global financial crisis (GFC), the financial landscape has oscillated from a 'lighter-touch' regime to greater regulation and, most recently, signs are surfacing that it may swing yet again to the former with talks of deregulating Wall Street.

BY CHUAH KUE PENG AND ZUL-FADZLI ABU BAKAR

OUTCOMES OF THE REFERENCE RATE FRAMEWORK

MOVING TOWARDS MORE EFFICIENT AND TRANSPARENT PRACTICES

The Reference Rate Framework (RRF) was introduced in January 2015 to replace the Base Lending Rate (BLR) with the Base Rate (BR) as the main reference rate for the pricing of new retail floating-rate loans and financing facilities. Further details can be obtained from *Bank Negara Malaysia's Annual Report 2014 Box Article: The New Reference Rate Framework*.

The RRF aims to achieve three key outcomes: to benefit consumers by providing more efficient pricing and transparency; to better reflect funding strategies of financial service providers (FSPs) while encouraging greater discipline in the pricing of retail financing products; and to effectively transmit monetary policy **(Figure 1)**.

This article discusses how the three objectives have driven the implementation of the RRF and the revisions made to the framework in August 2016. It also highlights the extent to which the intended outcomes have been achieved.

Specifically, consumers need to be aware of what constitutes the benchmark cost of funds used to calculate the BR and how this can affect movements of the BR. The characteristics of the benchmark cost will determine the pass-through from changing funding conditions of FSPs to BR.

IN A BID TO WREST ILLICIT FINANCING, **BANKS MAY HAVE UNDERMINED** THE VERY OBJECTIVES OF AML/CFT REGULATIONS.

Risks of 'De-Risking'

Supervisory reform of the financial services sector is increasingly robust, particularly on the anti-money laundering and counter financing of terrorism (AML/CFT) front.

In March, Taiwan's newly-created AML office saw Taipei upping the ante on money laundering prevention ahead of the Asia/Pacific Group on Money Laundering's third round of the mutual evaluation. On 20 July 2017, the UK announced its latest proposed AML watchdog – the Office for Professional Body AML Supervision hosted by the Financial Conduct Authority – to oversee its 22 professional bodies. By all accounts, the global AML/CFT calendar is packed to the brim.

Concurrently, for close to a decade, financial institutions (FIs) have boosted compliance and risk management capabilities using a combination of tools including integration of new technologies, increasing Chief Risk Officer powers as well as upping budgets and headcounts in risk and compliance. According to new figures from *WealthInsight*, global spending on AML compliance is set to grow to more than USD8 billion by 2017 (a compounded annual growth rate of almost 9%).

+ Financial institutions (FIs) have boosted compliance and risk management capabilities using a combination of tools including integration of new technologies, increasing Chief Risk Officer powers as well as upping budgets and headcounts in risk and compliance.

Yet, despite shoring up resources to combat AML/CFT, results continue to fall short. PwC's *Global Economic Crime Survey 2016* states that one in five banks have experienced enforcement actions by a regulator with failure to curb illicit business practices and many are balking at increasing compliance spend without seeing a light at the end of the tunnel.

As a result, many banks have opted to err on the safe side of caution by 'de-risking', a strategy that entails exiting markets and closing the accounts of clients considered "high risk" irrespective of potential monetary returns.

Unfortunately, the global effect of this "misapplied" strategy has perhaps brought the world two steps back in combating ML/FT activity.

DE-BANKED

The US Treasury's AML arm, the Financial Crimes Enforcement Network, defines de-risking, also known as de-banking, as "instances in which a financial institution seeks to avoid

Risk under review

Legislation designed to prevent financial crime may, in fact, be undermining the effectiveness of organisations tasked with protecting humanity's most vulnerable, writes **HELEN KING.**

There is a reason that financial inclusion was such a strong theme at the G20 summit in July. Non-profits – organisations which are relied upon by all governments to address both the root causes and the aftermath of conflict and terrorism – appear to have become the unintentional victim of the very legislation designed to protect the vulnerable.

No one questions the need for the global financial community to work together to develop a united and unflinching approach to tackling money laundering and the funding of terrorism.

But the legislation which drives this agenda – Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) – lays a burden on the financial services sector to conduct the due diligence required to make sure it does not facilitate criminal activities.

For high-value opportunities, the cost of this greater scrutiny on customers and their transactions is absorbed by banks. But for less lucrative projects, it is becoming much harder to find the required funding or banking facilities. This is because these ventures are often the

BY THE BANKING INSIGHT EDITORIAL TEAM

Regulating Fintech

UNDOING THE GORDIAN KNOT

Regulations are rising to **meet the challenges posed by digital disruption.** How will it reshape this bold new space?

In the city of Gordium, in modern-day Turkey, was an ancient wagon with its yoke tied in impossible knots. Legend was that he who could undo the knots would conquer all of Asia. Unable to resist, Alexander the Great took it upon himself and with a swoop of his sword, cut through the offending tie – nicknamed the 'Gordian knot' – and the rest is history.

The Gordian knot reminds us that the distance between an intractable problem and its solution is cleared through bold, decisive action.

In the case of financial technology (fintech), the tangle, or Gordian knot, for regulators is this: How should fintech be regulated without hampering its innovative spirit?

This is the central question regulators are faced with today, as it wades into uncharted territory, governing a windfall industry tipped to be worth USD4.7 trillion by Goldman Sachs.

A recent PwC report noted that 86% of polled chief executive officers (CEOs) in financial services worry about excessive regulation, not just for its cost implications but also its impact in an industry that thrives on creativity without boundaries.

On all sides, there is an acute sensitivity, and perhaps fear, that regulating fintech will end up creating another mirror of the existing banking system. Rather than 'coopetition' – the spirit of healthy collaboration amongst forces competing for the same pie – a heavy regulatory hand could, ironically, extinguish the fire that spurred disruptive innovation.

Haskell Garfinkel, PwC's Fintech Co-lead, told CNBC that regulators in the US are keenly aware that they must balance the twin mandates of financial services regulation – safety and soundness, and consumer protection – against the "flood of innovation occurring on the periphery of the regulated industry."

Over the past year, the tone from the top indicates regulators and overseers are rising to the challenge, setting landmark frameworks to give clarity on regulatory hurdles for incumbent banks and technology start-ups.

Solution

The Gordian knot reminds us that the distance between an intractable problem and its solution is cleared through bold, decisive action.

REACHING REGTECH'S FULL POTENTIAL

WITH REGTECH'S RISE, FINANCIAL INSTITUTIONS, FINTECHS AND REGULATORS MUST OVERCOME MULTIPLE CHALLENGES IN ORDER TO SEE SUCCESSFUL IMPLEMENTATION.

+ The regtech landscape is rapidly evolving and covers a wide range of possible services, ranging from those specific to industries such as financial services and healthcare, to cross-industry services such as vendor risk management, cybersecurity and identity/ background checks.

Technology empowers people and businesses to stay constantly 'switched on' in a rapidly changing environment, and we are increasingly reliant on it. Increased mobile usage, the rise of social media, and growing digitalization have led to an exponential increase in the amount of data available. Of the data currently available, over 90% was created in the last five years alone — this has enabled big data analysis as well as the use of machine learning and artificial intelligence (AI) to generate insights that were not previously possible.

In addition, competition in the financial services industry has increased significantly with the rise of financial technology (fintech). Many new business models are emerging from both fintech and incumbent financial institutions to address changing customer preferences as consumers are increasingly voting with their feet to whoever can provide quicker, cheaper services on demand.

OVERVIEW

Meanwhile, banks have faced an unprecedented level of regulatory scrutiny since the global financial crisis. Despite spending billions on regulatory compliance remediation programmes, many financial institutions have been dealt heavy fines and are still struggling to comply with regulatory requirements, resulting in the advent of regulatory technology or regtech.

Regtech is defined as "the use of new technologies to solve regulatory and compliance requirements more effectively and efficiently" as per the Institute of International Finance in its March 2016 article, 'Regtech in Financial Services: Technology Solutions for Compliance & Reporting'.

The regtech landscape is rapidly evolving and covers a wide range of possible services, ranging from those specific to industries such as financial services and healthcare, to cross-industry services such as vendor risk management, cybersecurity and identity/ background checks.

REGTECH APPLICATIONS FOR COMPLIANCE IN FINANCIAL SERVICES

Many financial institutions are currently investing in the following levers for improving regulatory compliance:

+ **Process automation:** Most regulatory compliance processes are currently manual and comprise collecting and consolidating

Of Privacy, Hackers & Cybercrime Unicorns

A global authority on cybersecurity weighs in on the shifting sands of **digital financial crime** in this exclusive interview.

Mikko Hyppönen is masterful on two counts: his remarkable ability to de-jargon technical concepts and the engaging manner in which he delivers it. His TED Talk has been watched over 1.5 million times and translated into 40 languages. *Foreign Policy* has named him one of its Global 100 Thinkers and he's lectured at Stanford, Oxford and Cambridge.

Hyppönen works with law enforcement officers in the US, Europe and Asia to combat cybercrime. As Chief Research Officer at F-Secure Corporation, one of the largest Nasdaq Helsinki-listed security firms in the world, he and his team took down 2003's lethal *Sobig.F* worm that wrecked over USD37.1 billion in damages. He warned the world about the *Sasser* outbreak and conducted classified briefings on the operation of the *Stuxnet* worm designed to sabotage Iranian nuclear enrichment facilities.

Operating the second-largest lab in the world out of Kuala Lumpur, his cutting-edge research involves hunting down cybercriminal attacks, malware outbreaks and predicting where the next vulnerability might arise.

Q In less than six months, we've seen large-scale cyber attacks launched against financial institutions. Equifax, a US credit monitoring agency, was hacked, compromising over 145 million Americans' private data, and Deloitte recently announced hackers had accessed sensitive blue-chip client information. Where are companies falling short?

Both companies you mentioned, Deloitte and Equifax, are great examples of companies that have a hard time securing their networks because they are so large.

When your organisation grows big enough, it's guaranteed you have some kind of a breach at some part of your network at all times. When you have 100,000 work

MARKET BEHAVIOURS

PRE-EMPTING MISCONDUCT

Latest study of finance history reveals patterns of malpractice behaviour.

It is said that there is nothing new under the sun – this is true of market misconduct.

In 1814, Charles de Berenger landed in Dover disguised as a Bourbon officer. He and his associates widely proclaimed the death of Napoleon, including in a letter transmitted to the Admiralty in London, using the latest modern technology – the semaphore telegraph. The group had bought gilts in the weeks before and made £500,000 (some £70 million today) in profit as the market rose on the news. The conspirators were prosecuted and their case set precedent and established the offence of Common Law Conspiracy to Defraud. Thomas Hayes was prosecuted under this same law for London Interbank Offered Rate (Libor) manipulation in 2015.

Has this technique for manipulating markets been repeated – do people "dress up" to manipulate markets in the modern world? The surprising answer is yes. In 1987, Federal Bureau of Investigation agents disguised themselves as traders to gain entry to the Chicago futures pits to uncover trading frauds. They were so successful that two years later a group of conmen copied the ploy. They disguised themselves as traders and wearing fake trader jackets and identity flashes they managed to trade fraudulently in the pits for over a year.

The ploy has been more recently adapted. In 2015, James Craig used the modern disguise of identity theft and social media to carry out the same manipulative strategy as de Berenger in 1814: publishing false market information. He imitated the Twitter accounts of two genuine broking houses to post false corporate information, causing rapid share price falls. Craig bought near the lows and sold on the market retracement.

A key problem in managing conduct risk is its potential scope. Many people assume that the range of potential malpractice in markets is limitless; in the words of the judge in a now-famous US enforcement case:

> **"The methods and techniques of manipulation are limited only by the ingenuity of man."**
> *- Cargill, Incorporated v. Hardin (1971).*

However, analysis of the behavioural patterns in actual cases of misconduct establishes that the number of malpractice techniques is more limited. At FMSB, we call this Behavioural Cluster Analysis. It demonstrates that the same market-abusive techniques are repeated and adapted and it is reasonably rare that a genuinely new ploy is invented.

This methodology is simple. Enforcement cases are reviewed to ascertain the pattern of malpractice behaviour indicated. These are then compared to determine whether the same behaviours repeat or are unique or different in each case. FMSB has reviewed over 400 cases from 26 countries over a 200-year period in all of the main asset classes. We found that just 26 patterns of behaviour repeat over time and across markets, asset classes and jurisdictions. This is the first-time analysis of this type has been undertaken with cases collated in a single place as a point of reference for, and as an input to, governance and oversight structures and methodologies.

The use of disguises in the cases of de Berenger and the Chicago markets is a somewhat peculiar example, but this type of analysis has a serious application in today's markets. Conduct risk is now systemic in scale. In the past five years, banks globally have paid some USD375 billion in conduct fines and misconduct has damaged trust in financial services. Identifying malpractice techniques is the essential first step to forestalling them, in particular if there is a more limited core group of identifiable practices.

As to the patterns, some are more common, others more intermittent. The list of 26 includes wash trades, the manipulation of closing and reference prices, ramping, layering and spoofing, market corners, front running, insider dealing and client confidentiality breaches. An exposition of each pattern is a considerable essay but a description of

How do I want to be remembered?

Leading with great values and purpose will unleash the potential within.

The 21st century is an exciting era; one filled with fear and hope.

A lot of people around the world are worried about widespread job losses to automation and artificial intelligence (AI) in the coming years. What will happen to them? How should they change? How should they prepare? The fears are genuine. Between 50%-65% of jobs have been predicted to disappear 20 years from now. For example, Russia's Sberbank is replacing 3,000 employees at the bank's legal department with a robot capable of writing claims. In five years, AI systems will be responsible for 80% of decisions at the bank.

Yet, the open source era has also made ordinary people more empowered than ever before. Technology gives us instant connectivity, which saves time, and allows anyone to bring anything to the world, literally. Right now, we have more time, more knowledge, more friends, and more opportunities for self-employment than at any point in history. Think Uber, Airbnb, and freelancing portals like *upwork.com.* It took Walmart 50 years to reach 10,000 stores; Alibaba took in USD18 billion in one Single's Day.

So, the real question is: What is the 21st century to you? Will you look at it as an era of job extinction, or one with endless possibilities? What legacy do you want to leave behind?

To move into the future, let's take a lesson from the past. Here is the story of Alfred Nobel.

In the mid-19th century, Alfred wasn't yet known as the founder of his Nobel Prize, but as a man who earned his wealth from inventing and manufacturing dynamite, an explosive made of nitroglycerine, which he patented in 1867.

In 1888, Alfred's brother, Ludvig Nobel, passed away. However, word got out that it was Alfred who had died. Numerous articles were written to recount his biography instead of his brother's.

Unsurprisingly, people's perception of Alfred was extremely negative. He was portrayed as a cruel man, the 'merchant of

Between 50%-65% of jobs have been predicted to disappear 20 years from now. For example, Russia's Sberbank is replacing 3,000 employees at the bank's legal department with a robot capable of writing claims.

 BY JULIA CHONG

Why 'LEI' Should be Part of Asia's Vocabulary

Legal entity identifiers may be the only thing standing between **Asian banks and MiFID II compliance.**

En route to becoming 'MiFID II-friendly', one of the first steps financial institutions (FIs) in Asia-Pacific need to take is obtaining a Legal Entity Identifier (LEI).

Currently, standard-setters around the globe including the Securities and Exchange Commission (SEC), Commodity Futures Trading Commission, Reserve Bank of India and Canadian provincial regulators require entities to use LEIs as the common identifier.

Under the European Market Infrastructure Regulation that came into effect on 1 November 2017, EU trade repositories must reject trade reports that do not have an LEI.

By 3 January 2018, MiFID II's "No LEI, No Trade" rule will make compulsory that all entities across all asset classes – including Asian firms dealing with EU counterparties – obtain LEIs. FIs will also need to put into place maintenance procedures to ensure timely renewal of their LEIs annually or risk a fine.

+ FIs will also need to put into place maintenance procedures to ensure timely renewal of their LEIs annually or risk a fine.

Aside to this, international standard-setting initiatives, such as the Committee on Payments and Market Infrastructures-International Organization of Securities Commissions (CPMI-IOSCO) that works on the harmonisation of key over-the-counter (OTC) derivatives data elements, also advocate use of LEIs.

Why is LEI seen as crucial in stemming systemic risk? Think 2008 Lehman Brothers as FIs scrambled to get a clear picture on their counterparty exposures or as regulators struggled to determine the systemic impact arising from Lehman's failure.

The adoption of LEIs by the US and EU arose out of this scenario – no one could quickly or accurately gauge the level of damage because there was no common international standard to link financial data

 | BY IVAN TAM

AI GLIMPSE INTO BANKING'S FUTURE

HOW **NEXT-GENERATION MACHINE** LEARNING IS SHAPING FINANCE.

Artificial Intelligence (AI) has embedded itself into multiple aspects of the financial ecosystem. From risk assessment and loan underwriting to robo-advisors and customer service, it presents banking with a myriad of new opportunities as well as challenges.

Digital Banking Report's September 2017 findings state 15% of firms use AI to gain a competitive edge and identify opportunities that manual analytics would have missed. A further 23% expect AI use to increase within the next 18 months.

Yet, few professionals have fully grasped the mechanics and extent of machine learning's impact on the banking landscape.

PREDICTIVE ANALYTICS

Machine learning – a term coined in 1959 by American pioneer in the field Arthur Samuel during

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