Evolving Trends in Governance, Risk & Compliance

Top row (left to right): Andrew Kerr, Chief Risk Officer, **Ambank**; Rozman Bin Shariff, Head of Operation Risk Management, **Bank Simpanan Nasional**; Lim Then Fui, Director, Risk Management, **Public Bank**; Geetha Sivapathasundram, Head of Group Compliance, **CIMB**; Matthias Chay, Head of AML Compliance, **Public Bank**. Bottom row (left to right): Sanjay Uppal, Group Chief Financial Officer, **Hong Leong Bank**; Jai Raj Batra, Country Chief Risk Officer, **Standard Chartered**; Sam Mukhopadhyay, Risk & Compliance Solutions Leader, **IBM**; Tiang Siew Lim, Chief Internal Auditor, **CIMB**; Rossaya Mohd Nashir, Head of Operations & Finance, **CIMB**.

SAM MUKHOPADHYAY, IBM: Our discussion will focus on innovative developments in business operations and case management relating to Governance, Risk and Compliance (GRC). We will explore the evolving role of an integrated framework in overcoming challenges and managing risk effectively, whilst still making decisions consistent with business objectives. The challenges that remain in understanding market and credit risk exposure across multiple silos are around achieving an integrated GRC effort and tracking the current compliance obligations being put forward by regulators in Malaysia.

ANDREW KERR, AMBANK: In Asia there has been a push to fix the infrastructure of banking and catch up with western banking. That's been a good thing in the sense that technology keeps moving so quickly that we were able to leapfrog into newer technologies and newer thought processes. AmBank has replaced the entire suite of risk infrastructure, or is in the process of doing so.

We've introduced funds transfer pricing – which was a competitive battle – and asset liability management; we were also able to replace the bar engine in the markets area. With that, we look to see the economic capital and portfolio management

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tools in the next 12–18 months, and really move into that sort of advanced status under Basel. In Basel III, what we have to be careful of in Asia, and particularly Malaysia, is a false sense of security.

Capital isn't really the issue – liquidity and funding is – but we are in a liquid environment at present. The benefit of portfolio management concentrations and correlations is something that we really need to understand better.

With Malaysia and Asia in general, we're funded very much at the short end. You can't change overnight on those types of issues, but that is one area that the banks need to improve on and really understand the asset and liability management perspective around operations and debt management.

The good news is that generally speaking we're really well placed, with capital liquidity and balance sheet quality. But it's highly competitive in Malaysia and Asia, and it's easy to drop standards. From time to time, in the past five years I've seen that in different areas. Right now I sense that with the global economy being as it is, Malaysia is beginning to feel the pain.

The growth is slowing and the confidence is down. There's no real shock visible as yet, but with pressure on growth in profits it's very easy to drop standards and targets, and that's probably collectively our biggest risk at present.

But overall it's a good news story, and I think the banks are spending a lot of money – they are lifting their infrastructure and are beginning to benefit. It's a good beginning as long as we keep good, commonsense discipline.

LIM THEN FUI, PUBLIC BANK: At Public Bank there is no difference in the business model; but we are extremely focused. Processes are to lower those risks and to implement a program management plan, both in the lending side and the management of those risks. There are two aspects of liquidity. Operator Compliance Risk (OCR), I think, is challenging because of the high runoff rates. And also the way that it is one size; you've got the terms of the Malaysians, the high selling rates, the management funds, the Bank Negara, that we have. Those are called the hard per cent runoffs, which I think needs some discussion.

The way you make a bank fit the behaviour of the depositors, was also a great thing to do, but it is something for a new model that is susceptible to the Central Bank. That is Public Bank's biggest challenge. The other point is the data quality, because we are very focused on detail.

Once you have got a loan, you don't ask the customers for any further data, so the data is very static. We have a lot more to do, and it takes a more granular analysis on top of the loans. Accessing the customer's hard data information (their income level, their age bracket, some other current states of the customers) is not very forthcoming, especially now with the industrial knowledge that comes in on these data professions.

JAI RAJ BATRA, STANDARD CHARTERED: From where I'm situated I see there are more challenges around Basel – there's a good experience around it, so the recent trend that we are seeing is that it is possible that the Financial Services Association (FSA) could be pushing the banks back to the standardised approach. Every bank has spent a lot and come up with the capital saves. That's what the regulators want to look at now.

There is a trend of wanting to move back to the standardised model, which would mean that we're doing whatever they want, doing what Bank Negara wants. I think from the perspective of the systems and models, from the risk infrastructure or risk philosophy – that is where it is embedded across the field and we do have a risk management framework at this time. But the other challenge we face is the people. Malaysia has an exceptionally high level of attrition, much higher than other countries.

SANJAY UPPAL, HONG LEONG BANK: What we have found really interesting is that within the organisation, the compliance aspect has clearly been a game-changer in Asia since the Asian financial crisis.

It has had an impact on the way you do business and on the cost of compliance. So I sat back and said, "Is this going to drive change in the way we should be looking at the returns that the bank generates?" You should be looking at the pricing, because some of the compliance costs will be passed onto the customers. Further,combine that with the increased complexity in our businesses, and the impact on pricing is compounded.

There were key elements in Malaysian banking sector that were apparent in the crisis, and I think all those principles have worked – the regulatory focus on capital, liquidity, business complexity and just an overall active level of supervision. It is admirable how much the banking system has lifted its own game and this was evident in the way Asia dealt with the recent crisis.

Having said that, what does this mean for the future? What I think is, yes, the recent crisis is going to change the way we do business, also pricing to customers etc. But do we have to change the way we operate in banking businesses?

In my view, one of the biggest challenges for the banking system is that, over the years, we have done everything as a business as usual (BAU)-plus.

What we haven't done is to say, "We need to rethink how we should operate in this new reality?" The current approach makes it more complicated, more expensive, but perhaps not effective enough.

We need to consider four key elements: first, the operating model itself; second, the people and capabilities; third, how are we leveraging technology? And fourth, is the focus on governance. The primary challenge is that there is going to be a higher cost of doing business, and we have to look at how we create the right pricing and returns in our business.

First element is the banking financial model and how we manage our businesses to ensure adequate controls and make it more efficient , because the current approach has created further complexities and inefficiencies.

The second element is the experience. Today, unfortunately, we live in a fast moving age, and new bankers undergo very brief training and that is part of the challenge. You meet a person, and they may have done a reasonable post-graduation, or maybe they're not even qualified, but they want to be an assistant manager right away. So, how do you bring people into the system with that level of expectation?

Thirdly, I think some of us have to bite the bullet on technology. It comes back to this situation because banks have spent $15 million or $18 million over the year, and you are thinking, "Well, can I just spend $5 million more?", not realising if you just spent $25 million, you could replace the entire platform with current generation technology.

And lastly, it is just the mindset relating to risk management. We take it for granted, and so very often institutions deal with much of compliance and risk reactively rather than proactively. This comes back to fundamentals. How do you move your approach towards risk management from ticking-the-boxes to becoming more proactive. There is also the governance aspect that has to be built in here. This crisis has proven beyond doubt how closely the banking system is linked to the broader economy.

SAM MUKHOPADHYAY, IBM: In terms of the BAU versus a fresh paradigm, how do you see the practical angle of it? Is it workable? Is it doable?

SANJAY UPPAL, HONG LEONG BANK: I think it is easier said than done because it has many implications.The first implication is the cost; second is the management process. Before I moved here, I was Group Chief Financial Officer at the Emirates NBD, Dubai, for five years. One of the things I did was to establish new Enterprise Resource Planning (ERP) and Datawarehouse systems across all group entities, which included the conventional bank, Islamic Bank, brokerage, investment bank, asset management, etc. Selling it to the management and board took a few months and a great deal of effort as the investments I was asking the bank to make was in excess of the total finance cost for the previous three years.

By the time we implemented the ERP and established the enterprise-wide datawarehouse, it changed a lot of our organisation around it. As a result, at the onset of the crisis our level of preparedness was amazing. We had dashboards and immediate information access for nearly everything because we had developed our capabilities extensively.

So when you're talking about driving a change, it comes down to how you position the case and demonstrate the value. But I think it's doable, and I believe it is critical to the future of the banking system. There are a lot of current platforms that require upgrading.

ANDREW KERR, AMBANK: Absolutely, and I find that interesting coming from a finance person. It says: "If I'm going to do what you've just said I have to write off all the old systems, because the reason I keep patching them is finance driven". Whereas the other is more visionary, and it's about getting the balance right. There's no doubt if we opened a bank today, we'd be in paradise compared to the legacy system carrier – but there is that cost element.

For Malaysia, the allocation of capital is different between businesses. Banks in Malaysia, and local banks in particular, are at various levels of maturity. Risk adjusted pricing, if it's well understood, it is not necessarily executed well. If we had better understood customer information systems, either for retail or non-retail, and understood all our exposure to a customer, all the capital allocations by product and the risk adjusted returns – if we all understood that, charges to our customers would be different.

From watching market practice, it's clear that we don't. And we call it competition. But it's really not understanding what's going on. You can certainly have loss leaders, but you can't have portfolio loss. If you understand the cross-sell, that's terrific; if you don't, then you're making guesses, which is dangerous.

There is a great deal of noise this year on risk appetite. But it's really misunderstood, as a banking profession. Even stress testing is just not well understood. Stress testing in a normal environment is what drives your risk appetite. You need to do more stress tests to see what else you need to be mindful of.

Risk appetite, quite frankly, is about a 'buy/hold/sell' strategy. What do I do more of; what do I

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keep roughly at that level; and what do I ease off/reduce/get out of? If you have good systems, you can do it (stress testing) very quickly. You can run programs and do stress testing overnight. I can tell you, up until this month, it took AmBank two months to run stress tests because it was all non-integrated spreadsheets. With all the new systems, this is now an overnight exercise, but that's been a long time coming.

But again, the evolution is progressing nicely, and we are getting on with it. So risk adjusted returns, capital allocation systems – are putting us on the right track. The issue about data, we've all experienced it, and I've done it with four different financial institutions – the headache of data cleaning is just a nightmare – getting it right, adjusting it all, then getting back to the project.

GEETHA SIVAPATHASUNDRAM, CIMB: I agree from a compliance perspective that this is something we need to do, to be able to address the points that Andrew outlined. So it's always a reactive approach to compliance, where in fact having your risk managed with those compliance measures in place at the outset helps. If we get our governance right, then all the issues that Sanjay mentioned would be addressed.

Sanjay mentioned about 70 per cent compliance and not getting much time allowance. But if we had that right in the first place, it's just a matter of doing business. From a company's perspective, that's a change that I would like to see people looking at: compliance more to facilitate business. It is a cost, but it gives the long-term benefit.

ANDREW KERR, AMBANK: Just to add one more word 'culture', because the word 'governance' sometimes hides it. For a start, getting the culture right makes governance easy.

GEETHA SIVAPATHASUNDRAM, CIMB: Exactly, and I think the gentleman that spoke about the person who thinks they can become a manager or a senior manager in one or two years was very relevant. So in the process, the training is actually compromised. You are here, trying to fight the talent pool, and saying, "I want to keep this person", so just keep on rewarding him for every little thing that he does. And in the process, we are losing out in terms of the core values of the bank.

TIANG SIEW LIM, CIMB: I hear people talk about talent management, but in Asia there is a big issue of having people with the right skills set. In Malaysia, there's the issue with our own education system; the way the interests are being produced are not aligned to business, and the work culture is different.

A number of people at the top of the data entry chain are paid about 800 Ringgit. They don't care very much, and the employee sees that as a very mundane job. So that's a challenge. How do you attract the right talent, and commensurate them in a proper way so that they see pride in their work? Of course, there's communication and understanding.

These days, you train someone and they become reasonably good. Somebody else comes and takes them over, not just locally but probably overseas, right? Malaysia goes to Singapore, Singapore goes to Hong Kong – you know where the attraction pool is.

SAM MUKHOPADHYAY, IBM: Are there any specific points of view around aspects of compliance or security?

MATTHIAS CHAY, PUBLIC BANK: The greatest challenge is compliance versus business. The expectation from the Central Bank is very high; they expect you to input a lot of sources to ensure a full compliance. But on the other hand, most would like to know that it is very cost-effective in the business.

SAM MUKHOPADHYAY, IBM: Do you mean across most aspects of compliance, or any specific areas? So when you say it's costly, do you mean collection of the data, putting the logic in place and so on?

MATTHIAS CHAY, PUBLIC BANK: Including the system, the cost of investment involved in establishing a good system, in effect, to monitor suspicious detections.

ROSSAYA MOHD NASHIR, CIMB: I would like to touch on points raised about culture and compliance. In many regions, people tend to meet risk and compliance by leaving all those aspects to the people responsible, the senior management and the compliance or risk departments.

So there needs to be a review or a mindset change to help them with that. And that the first level of defense for compliance and risk should be at the business units or the frontliners themselves.

SAM MUKHOPADHYAY, IBM: Can you make another point around how we match up the finance operational side of things? Do you do any kind of cost benefit for the analysis?

ROSSAYA MOHD NASHIR, CIMB: Yes, for the past three or four years we have good processes at the front line, with compliance checking and monitoring. We have dedicated officers to do that initially and then it comes back to us.

SANJAY UPPAL, HONG LEONG BANK: The key piece of running any business is the tussle between how much money you make and how you make it. And if you are always focusing on only how much you make, you are very likely to ignore everything else. If I was a shareholder, how you make the money is more important to me.

At another bank where we had issues on client data, we at the management committee pondered, "What do we do with this, because we are just not getting credible customer data". The CFO looked at the revenue line and the cost line, and said: "Where's the revenue coming from customers? And who gets rewarded on the base of the revenue? It's the frontline."

So we assigned the responsibility for completeness of customer data to the front-line with a target to complete it in one year. This became a key performance metric for relationship managers and branch managers in their annual performance assessment. This approach served us very well and ensured that the frontline assumed complete ownership of customers.

I do at times wonder about a possible disconnect between the management of loans and deposits businesses with the same banks competing through driving down loan pricing while offering higher rates on deposits. From a returns on risk perspective, it highlights fundamental challenges in sustainability of the returns.

SAM MUKHOPADHYAY, IBM: Even today, that is how I do it. And that's why we developed our models, and of course you do get some wastage, but we still get 85 per cent of data, so that does benefit. Let us say a relationship manager fills in the data; it goes to the back office, but who is checking? It is not like it goes back to the relationship manager to set it right to be the way it should.

GEETHA SIVAPATHASUNDRAM, CIMB: Having seen systems and after speaking to bankers from your section, what's your take in terms of banking in Malaysia?

SAM MUKHOPADHYAY, IBM: In Malaysia, I don't think we have a mature enough view to see down the road, to be honest. But if I look at the level of maturity Malaysia has regarding peer maturity across few geographical areas, I would probably mention Singapore, plus a few others.

There are two things to it. In a risk and value context, I don't think we have lined it up to a 'method' yet. In other words, in Malaysia we haven't reached the point where we can actually map it to value. In IBM, we have benchmarks and studies where we map it to a particular process, maturity or value maturity, whether or not it is data allocation, technology, analytics and so on. So that's my first point.

Mapping it back to compliance, operation and the like, to operational efficiency and operational risk – not just operational as an English word – but as the operational risk in Basel II, our take is that banks which have actually defined some sort of a uniform taxonomy (taxonomy being derived from process and methodology), are probably in a better place than the ones who have not done that.

If you are looking at the process side of operation and risk, the compliance aspect, you need to fine-tune elements such as what do you need to do and who does it? Leave aside the issue around Key Risk Indicators (KRI) and Risk Control Self Assessment (RCSA), which are basically sort of checks in the box, or certain other actions in compliance, or any other area.

But if you have an intersection of more than 60 per cent or 70 per cent between operational risk and compliance, then the higher the intersection, the better placed that bank is. So was that addressing your question?

GEETHA SIVAPATHASUNDRAM, CIMB: Yes. In the Asian region, specifically in the ASEAN context, which country do you think has achieved something?

SAM MUKHOPADHYAY, IBM: In my view the risk and finance element of it is well executed in Australian banks. In terms of the Big Five, I think four of them have done pretty well. In terms of combining with the compliance side, I would mention two banks that are probably very well placed.

Others are more or less getting there, and it is better executed in a more classical bank as opposed to an investment bank. In Singaporean banks, looking at the value aspect, I think they are probably not at the same level of maturity as Australian banks are. Korean banks, however, are extremely strong and well managed.

ANDREW KERR, AMBANK: I would probably throw Hong Kong into that.

SAM MUKHOPADHYAY, IBM: Yes – Hong Kong as well.

ANDREW KERR, AMBANK: In terms of speed to improve, Korea was probably the best-improved post crisis. They invest a lot in technology, and earlier than most. Malaysia would probably be ahead of the pack of in terms of Indonesia, Thailand and the Philippines. Thailand is investing better and Indonesia is catching up, the Philippines is getting there, and Vietnam's stepping up. Cambodia is a

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little behind, but we are reasonably well placed. Again, a danger for Malaysia is to think we are way up here, because we are not.

SAM MUKHOPADHYAY, IBM: Data management is ultimately not very romantic, but it's still right there. Data is proving to be the critical element, so therefore whatever level of maturity you reach, data – or rather, data integration – is proving to be the pre-requisite for any level of maturity. And back to my comment earlier about the taxonomy, again, that is data and workflow, and process and all of that coming together. So there is no running away from data.

ANDREW KERR, AMBANK: That comes from what they call conscious decision-making. So there's a one-off transaction through a pricing model, but it's somewhat irrelevant. You actually need to have the MIS by group and by company, to see whether you can afford the discount. When you get one-off transactions, you have no relationship, so you need a system that captures a customer, group, by-product, and then the overall risk adjusted return. And what that tells you as a whole is, "Can I do that deal or not". The market is saying, "My relationship return is four per cent, my cost of capital is 12 per cent. I'm killing my shareholders". I can tell you we don't have that kind of data, but we are building it. so we're building on it and it takes a lot of time, because we have 22 legacy systems we are trying to attach together.

SAM MUKHOPADHYAY, IBM: Adding to the point about risk and value, if a bank approaches the matter from the point of strategic capital management or a better way to say it, strategic business planning, then it helps you with the threats that you need to track, in the sense of an active balance sheet. It won't be achieved overnight but at least it gives you the structure to approach it in a systematic way. *




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