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Responding to the new normal in financial services

- The future of asset servicing: Shaped by three disruptive technologies
- Getting a handle on financial crime compliance in Southeast Asia
- Managing conduct risk: Addressing drivers, restoring trust
- Five things major financial institutions can do to harness disruption

Deloitte.

In this issue

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Change and increasing complexity are the new normal

The pace of change in the financial services industry has accelerated with disruptive technologies, regulations, and business models. The landscape has changed drastically over the last few years and tomorrow's environment will no doubt be different but no less rich in possibilities for those who are prepared. The emergence of a new normal means a need for innovation in terms of how financial institutions meet the needs of their clients.

In our first article, we explore three disruptive technologies that will drive dramatic change and have a profound and lasting impact on service providers' operations in the asset management sector over the next five years.

Next, we share some common regulatory themes compliance executives should keep in mind when developing a Financial Crime Compliance framework.

We then tackle the challenges that come with managing conduct risk. Conduct is a lens into the culture of organisations, and conduct failings seem to be widespread. To help financial services organisations be proactive about misconduct, our article explores its fundamental drivers, the various initiatives that have arisen in response, and some of the emerging technologies firms can enlist to help manage conduct risk.

Wrapping up this issue of FSI*Review*, we take a closer look at five things that financial services firms can do in order to harness disruption.

We hope that you will find this edition of the FSI*Review* an interesting and insightful read.

Ho Kok Yong
Financial Services Industry Leader
Deloitte Southeast Asia

The future of asset servicing: Shaped by three disruptive technologies

A huge wave of technology disruption is heading toward the asset servicing industry. Within a five-year timeframe, robotic process automation (RPA), blockchain and cognitive systems will drive dramatic change and have a profound, lasting impact on service providers' operations. According to a survey by the CFA Institute, 54 percent of respondents viewed asset management as the industry most at risk from disruptive technologies.[1]

We believe that these disruptive technologies offer enormous potential for asset servicers in creating efficiency, reducing risk and improving quality of service to clients. It has been suggested that automation alone could reduce headcount in the asset servicing industry by 60-70 percent while also achieving a cost savings of approximately 30-40 percent.

The asset management sector is ripe for disruption

Why is asset servicing standing squarely in disruption's path? The industry employs approximately 200,000 people[2] worldwide. Many providers are still constrained by the legacy of acquisitions, poor integration, multiple technology platforms, and a high level of customised manual activity. Some of the technology platforms still in widespread use date back twenty years or more and asset servicers still receive tens of millions of instructions by fax every year. It is argued that the industry employs such a large number of people due to inefficiencies that accumulated in its systems and processes over many decades. Many of the fulltime employees (FTEs) in asset servicing perform manual, repeatable tasks that automated technology can now cost-effectively replace.

The challenge for asset servicers is considerable: since 2008, the regulatory environment has been the dominant consideration, thereby inhibiting the industry's development.

The value of assets under management has been rising over the past two years, however asset servicers have been unable to keep expenses under control which are on the rise again. It's felt that while technology has evolved, the industry has failed to keep pace. With the market driving asset servicers to achieve operational excellence, it's clear that some of these processes tied to legacy technology are the first in the firing line. Opportunities have emerged for new technologies to replace back- and middle-office repetitive, manual and cost-inefficient processes, with improved process automation-delivered on a continuous basis.

1. "Robots will strike asset management firms first," Bloomberg, 3 May 2016. Link: https://www.bloomberg.com/news/articles/2016-05-03/cfas-warn-asset-management-firms-should-fear-fintech-most
2. Deloitte Research, 2017

"The adoption of disruptive technologies in the asset management industry is gaining traction in Southeast Asia and it's not just hype. By harnessing the power of disruptive technologies, financial services firms are boosting their risk management and compliance capabilities as well as quality of service to clients while dramatically reducing the required time, cost, and effort."

Yacin Mahieddine, FSI Consulting Leader, Deloitte Southeast Asia

What are disruptive technologies?

Disruptive technologies are technologies that do not develop in a linear way, but evolve much faster and have a greater impact than traditional technologies (see Figure 1). In this article, we draw our attention at three technologies because we believe that each represents the greatest disruption posed in the short-term (automation), medium-term (blockchain) and long-term (cognitive). While all three technologies pose a potential disruption to the industry, what is important to note is the exponential impact of such developments.

Figure 1: The evolution of technologies

1970s

Mainframes

Enabled batch processing overnight

1990s

Local Networks

Enabled data centers, intranets and corporate systems

2010s

Mobile

Spearheaded frictionless payments

1960s

Semiconductor Microprocesses

Allowed the replacement of physical recording with digital data

1980s

Terminals and PCs

Automated banks and branches and facilitated offline remote banking

2000s

Smart Devices

Created a new medium to interact with clients and collect data

Today

Innovations such as

Robotics

Blockchain

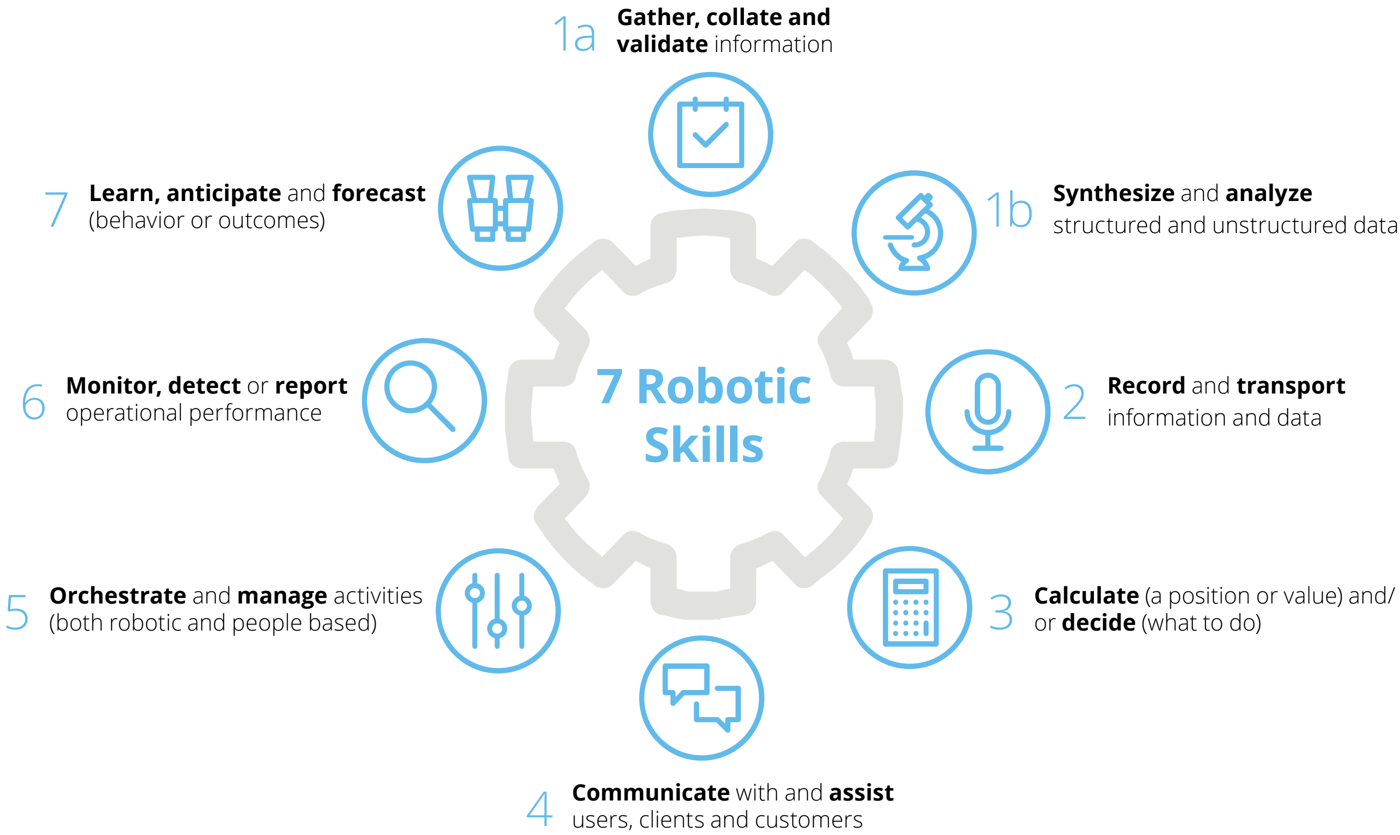
Cognitive

Robotic process automation (RPA)

RPA could replace much of the manual work involved in asset servicing to handle post-settlement tasks like trade processing, reconciliation and reporting—both for clients and regulators. The technology has been maturing over the past decade to a point where it is now suitable for enterprise-scale deployment, and can be rolled out quickly and at low cost.

A license for a software robot is likely to cost less than an onshore or offshore staff member, so the commercial attractiveness of this approach is self-evident. There are non-financial benefits too, as robot-based process performance is designed to be more predictable, consistent, and less prone to errors as compared to a human process. Moreover, a robot workforce can typically be deployed in a matter of weeks. Once in place, new processes can often be assigned to them in days, if not hours. A range of robotic tools can provide powerful skills to an integrated workforce is outlined in Figure 2.

Figure 2: Seven robotic skills



Blockchain

The World Economic Forum has forecast that by 2025, at least 10 percent of global GDP will be stored on blockchain platforms.[3] One of the most widely hyped technologies right now, a blockchain is one form of a distributed database for recording transactions where every participant on the network shares a copy of each transaction. Blockchain allows for decentralised processing, validation and authentication of transactions. It also has several unique and valuable characteristics that over time could transform a wide range of industries.

When applied to asset servicing, blockchain would result in a completely redesigned value chain. Blockchain may eventually go so far as to eliminate the requirement for multiple onerous reconciliations. If funds are selling directly to investors, and this is recorded on the blockchain, it may also remove the need for the transfer agent to monitor subscriptions and keep a share register of participants in the fund, further streamlining the whole process.

Cognitive technology

Born out of research into artificial intelligence (AI), cognitive technology comprises several areas including natural language processing, computer vision, speech recognition, and robotics. These tools and technologies are also known as intelligent automation. More advanced than bots which just perform process-based, repeatable tasks, cognitive technology mimics human judgement in its ability to recognise handwriting, identify images, and use natural language processing to interpret information. Machine learning capability allows these tools to improve over time.

Though not yet as mature as RPA, we believe cognitive technology has huge transformational potential. An important emerging trend is where enterprises are starting to employ RPA together with cognitive technologies such as speech recognition, chat-bot, natural language processing, robo-advisors and machine learning to automate perceptual and judgment-based tasks, which were traditionally performed by humans. Integrating RPA and cognitive technologies extends the automation potential to processes that require perception or judgement and unlocks new areas within the organisation to deliver business outcomes such as greater customer satisfaction, increased revenues and increased efficiency. The decreasing costs of data storage and processing power are enabling rapid developments in the field of AI.

Today, wealth management firms use intelligent automation to review and analyse portfolio data, determine meaningful metrics, and generate natural-language reports for their customers on the performance of each of their funds. The uses of AI are potentially limitless, but the tools are also more expensive to deploy than RPA tools and they take months, rather than weeks, to implement.

Preparing for the wave of disruption

Five years from now, the asset servicing industry will look very different. The onward march of disruptive technology calls for a profound shift in thinking among asset servicing providers. Regulation was the driver for the past decade's activity; the next five years will see technology at the forefront of providers' strategic thinking.

Upskill senior management: Change the profile of your senior management team to include more technology-aware, technology-focused senior executives.

Shift hiring plans: Automation will replace functions, not jobs, and technology will augment, not replace, the role of humans. We foresee a hybrid workforce of autonomous FTEs and bots. Service providers should start thinking about the skills required around governance and managing this resource pool.

Recruit expertise: Hire an innovation leader who will be very close to the executive committee of the company, and give real substance to the strategy business unit of asset servicing. In practice, this could mean moving power from the COO to the strategy and innovation function.

Move up the value chain: Asset servicers should focus more on how they provide more value added services-spending more time talking to the client, more time providing them with market and regulatory intelligence and becoming the trusted business partner of the asset manager instead of just being its back office.

Define success: Defining multiple project goals clearly and avoid focusing solely on cost reduction will increase the likelihood of a project being determined a success. Experiments led from the bottom-up rather than top-down work in most cases. Joint ownership between technology and operation also increase the chances of project success and avoids silos.

Get faster, fast: It's critical for asset servicers to form a point of view about the technology that threatens to disrupt their market. Many asset servicers rely on big, monolithic technology platforms. It's no longer acceptable to use 18-month IT deployment windows. You've got to come to market faster, so you need to architect your IT to iterate faster.

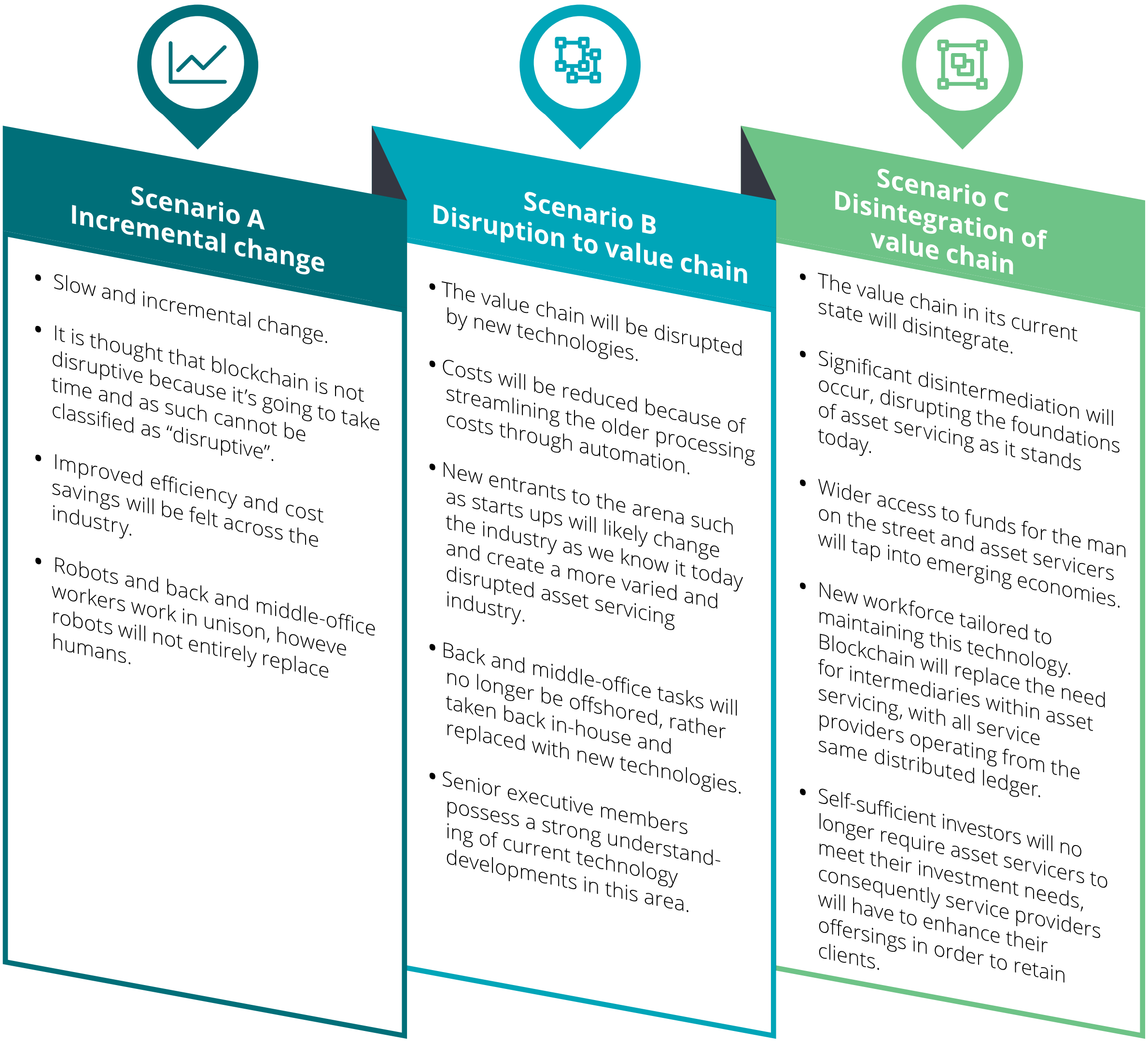
Split divisions: Organisations should consider setting up a purely technology-focused operation with high levels of automation and no legacy systems and processes, possibly as a joint venture with a FinTech play. This would run in parallel with the existing asset servicing business, and could even be separately branded. It could be scaled up while winding down the legacy operations over a similar time period.

3. Deep Shift Technology Tipping Points and Societal Impacts, World Economic Forum, 2015.

Possible outcomes

Three outcomes have been identified as possible avenues that the asset servicing industry will take over the next number of years. Scenarios A, B and C discuss what the potential impact that disruptive technology will have on the value chain of the asset servicing industry.

Figure 3: Possible avenues that the asset servicing industry will take over the next few years



We believe scenario B to be the most likely outcome, whereby the value chain will be disrupted, but not disintegrate entirely. However, in order to capitalise on the upward growth trend and increase profits, asset servicers will need to invest in new technology to meet the needs of their evolving client base.

RPA, cognitive systems and blockchain will create an asset servicing industry that looks very different from what we see today, but this disruption will happen in stages over the next three to five years. We anticipate a domino effect whereby asset servicers will begin implementing RPA to tackle low-level, repeatable, process-based tasks. They will follow this with blockchain as this technology matures. As RPA becomes embedded, it will pave the way for introducing cognitive technology and AI that applies rules and human-like judgement to asset servicing roles.

It's always better to be the disruptor than to be disrupted. Now is the time for asset servicers to start formulating tactical and strategic plans, in order to be ready for when the technologies' tipping point arrives and the waves begin to crash down on the industry.

The article is an excerpt of the report, "The future of asset servicing: Shaped by three disruptive technologies."
To receive a copy of the full report, drop us an email at sgindustries@deloitte.com.

Getting a handle on financial crime compliance in Southeast Asia

Financial crime threats in SEA

Managing financial crime compliance is becoming increasingly critical for investment management (IM) firms such as investment asset managers, retail fund providers, hedge funds, wealth managers, investment platforms and asset service providers in Southeast Asia (SEA).

Financial institutions in Singapore and Malaysia – two strategic locations with porous borders and open economies – face the threat of money laundering. IM firms in these two countries are particularly at risk of being conduits for Money Laundering with their primary business of receiving and making investments internationally being susceptible.

In light of this, the regulators in Singapore and Malaysia have developed specific Anti-Money Laundering (AML) and Counter Terrorist Financing (CFT) regulations to impose compliance requirements on IM firms to manage AML/CFT risks they are exposed to. These regulators have set a strict tone on the tightening of governance, Customer Due Diligence (CDD) processes and strengthening of internal controls.

With these constant updates, the regulatory bar keeps rising rapidly. With this in mind, what do IM firms have to look out for and how can they develop their Financial Crime Compliance (FCC) framework to meet the ever-changing regulatory requirements and expectations?

First, we must consider the common regulatory themes to keep in mind when developing an FCC framework. Malaysia revised its Guidelines on Prevention of Money Laundering and Terrorism Financing for Capital Market Intermediaries in 2014 and Singapore published its amended Prevention of Money Laundering and Countering the Financing of Terrorism – Capital Markets Intermediaries in 2015.

While regulations in these two countries will differ, IM firms in both Malaysia and Singapore have to take note of four key regulatory themes, when developing their FCC frameworks:

1. **Applying a risk-based approach** – IM firms are required to develop sound policies and procedures to manage risk. Based on these policies and procedures, these institutions need to perform risk assessment, monitoring risk mitigation of money laundering and terrorism financing risks.

2. **Screening new launches for money laundering and terrorism financing risk** – New products and technologies need to be screened for money laundering and terrorism financing risk, and necessary approval is required before products, practices and technologies can be launched.

3. **CDD for all customers** – Screening is mandatory for all customers, natural person appointed to act, connected parties and, Beneficial Owner, regardless of risk profiles. All IM firms are expected to perform ongoing monitoring of their customers and detect money laundering and terrorism financing risks. In addition, firms must identify the beneficial owner of entities and trusts that they are working with. Regulators in both countries allow the use of threshold of 25 percent ownership to identify the natural person who ultimately owns the legal person/arrangement.

4. **Reliance on third parties and group policy** – the guidance in both Singapore and Malaysia allows for the use of third parties by firms when performing CDD, but sets out limitations in terms of the extent to which these third parties can be used. For example, in Malaysia, IM firms must apply a risk lens to discern the reliance on third parties they engage; where the key consideration is the extent the third party has applied recommendations from the Financial Action Task Force on Money Laundering (FATF). Firms are prohibited from relying on third parties to verify the beneficial owner and those located in higher risk jurisdictions. In Singapore, there is a requirement for IM firms to implement group policies and procedures for its branches and subsidiaries within the financial group to share information required for the purposes of CDD, and for money laundering and terrorism financing risk management. Furthermore, the Singapore regulations do not allow third parties to perform ongoing monitoring for the IM firm. Reliance on third parties is subject to appropriate assessment and proper arrangement with the third party that the IM firm is relying upon the former's CDD.

"With the avalanche of shifting regulatory requirements and new criminal threats, compliance will only get more challenging and costly. The investment management sector will have to innovate and evolve compliance frameworks as well as rethink current day models in order to stay ahead."

Radish Singh, Financial Crime Compliance Leader, Deloitte Southeast Asia

'Effectiveness' is the new buzzword

In the current landscape, compliance will only get more challenging and costly. So what can firms continue to do to enhance their financial crime compliance (FCCC) framework?

Getting the FCC compliance target operating model right sounds simple. However, the more complex the IM firm and its business, the more challenging it is to administer control and surveillance. In addition to the 'business-as-usual' activities, ensuring effective responses to address tightening regulatory changes and increasing regulatory expectations demands equal attention.

It is important for the compliance culture to shift from being process-driven to being "risk aware" in order to appreciate the complexities of the FCC operating models, and adapt appropriately in response to new threats and emerging typologies with its associated red flags.

While it may be tall order, a good starting point is to develop three lines of defence – the front office, compliance and audit – with well-calibrated risk tolerance principles that work like a well-oiled engine to detect and prevent financial crime. This demonstrates, inter alia, that the IM firm has a good grip on its "single client view" and is effective in monitoring and managing FCC risk.

Board governance and management supervision must be demonstrable. Although easier said than done, there is a need for evidence clear reporting, provision of good quality risk dashboards, and clear channels to escalations of key findings. The Boards and Management should be actively involved in critical decisions making that impact the management of FCC risk for the organisation.

The FCC risk assessment across the IM firm and lines of business needs to be effective in calculating inherent risk and assessing robustness of controls to manage such risk. The outcome of the risk assessment must – and it is critical that it does – inform the overall framework, policies, procedures, process architecture, people, technology, customer risk profiling, monitoring and assurance exercise as well as help design the Money Laundering Reporting Officer (MLRO)'s dashboard to the management. While the subject may sound unexciting, it is worth repeating the importance of continuously beefing up the gatekeeping function – performing robust Know Your Customer (KYC)/CDD processes. The better the quality of the CDD process, the better the ability of the IM firm to assess customer risk and monitor the relationship on an ongoing basis. Firms need robust regimes to not only identify risks at the point of on-boarding but monitor such risks throughout the lifecycle of the customer with the firm.

To do so, IM firms will need to separate their operational and advisory functions. It is important that the employees who have 'business-as-usual' tasks and those that ensure the effectiveness of the controls framework are not one and the same. IM firms should also be aware of the evolution in trade finance compliance or trade-based money laundering compliance and correspondent banking relationships oversight. For their trade business, firms need to institutionalise a framework that broadly addresses the review of risk through the trade documentation, trade routes and vessels, screening of parties, assessment of the legitimacy of goods (from dual use risk and under/overpricing) and whether sanctions parties/countries are involved. There is very little appetite from regulators for failures in the compliance framework for IM firms that undertake trade finance business or establish correspondent banking relationships.

In addition, having a transaction monitoring system that focuses on link analysis can help. This allows for common sources of wealth or ultimate beneficial owners' transactions to be assessed holistically. IM firms should make more investments in analytics to optimise the transaction monitoring technology to improve effectiveness of the monitoring and challenge and audit abilities.

IM firms should also look into the documentation of the overall control architecture, which includes the labyrinth of processes and technologies put in place to mitigate FCC risks. This can be documented as a single source of truth and assessed to ascertain whether the controls' environment meets regulatory standards and whether there is more work needed to plug gaps.

Continued vigilance

The FCC framework will continue to evolve in line with the changing business landscape and regulations are expected to tighten.

When implementing a risk-based approach, identifying key indicators where the IM firm needs to perform a deep dive analysis to address any potential risks the organisation can be exposed to and the sufficiency of controls in place to manage such risk is essential. The regulatory bar on financial institutions (FI), including IM firms, in Singapore and Malaysia have risen so much today that "risk-based approach" translates to "heightened risk-based approach" when designing AML/CFT frameworks and assessing associated risks and controls. Compliance frameworks need simply to be prudent and defensible in today's regulatory environment.

In addition, with the recent actions instituted by regulators in both Malaysia and Singapore on certain FIs, the regulatory arbitrage should narrow fairly swiftly with industry participants expected to further tighten compliance efforts. IM firms in SEA will also be required to invest more in this area as they harmonise their global regulatory standards and guidelines across their footprint markets. The natural consequence of this will arguably be increased compliance costs with resultant thinning profit margins for some.

However, it is important for FCC leaders to keep in mind that the monetary penalties for non-compliance and damage to a firm's reputation far outweigh the cost of compliance. On the plus side, this may call for integration or more innovation in business, cost effective service delivery models, digitization and compliance efficacy and use of utilities that can operate within the regulatory regime without impediments to not just reduce cost, but also manage risks.

The article, written by Radish Singh, SEA Financial Crime Compliance Leader, first appeared in the May 2017 issue of Performance magazine, a triannual digest for investment management professionals. To receive a copy of the publication, drop us an email at sgindustries@deloitte.com.

Managing conduct risk: Addressing drivers, restoring trust

There has been no shortage of well-publicised and highly damaging misconduct scandals within the financial services industry over the past decade. Conduct is a lens into the culture of organisations, and conduct failings seem to be widespread across several jurisdictions, cut across financial services organisations and involve both the retail and wholesale sides of business. A large number of customers have claimed sizeable loss and there has been significant reputational and brand damage to firms. A raft of new regulatory initiatives, substantial fines and expensive remediation programmes have also ensued.

Drivers of misconduct

Conduct is a current priority for both the financial services industry and its key regulators.

Understanding and addressing the drivers of misconduct is an essential step in improving standards of behaviour, being able to identify key conduct risks, designing pre-emptive enterprise-wide conduct programmes and meeting regulatory and marketplace expectations.

As such, we have explored the findings of various conduct related enforcement actions, regulatory and industry reviews, government inquiries and firm remediation programmes to discover the common themes that lie beneath poor conduct. While many of the recent high profile cases of misconduct have occurred within banking (and therefore many examples in this paper are drawn from that sector), conduct is not a bank only issue. Regulatory and community interest and expectations around conduct cut across sectors, and financial services organisations of all types are under scrutiny.

The eight key drivers of poor conduct are outlined in Figure 4. These eight drivers often overlap and work together, to create an environment that incentivises, reinforces and spreads problematic behaviour.

Figure 4: Drivers of misconduct

Customer needs and suitability not guiding product lifecycle practices

Product design, marketing, sales and advice, as well as post-sale practices, are driven by concerns about "what will sell the most" rather than what the customer needs and what is most suitable for these needs ("is this right for them?").

Failing to have a balanced scorecard for HR decisions

Recruitment, remuneration, promotion, professional development, and dismissal decisions that value short-term revenue generation over other important aspects of performance.

Individuals and leadership not responsible or held to account

Failure to penalise individuals involved, as well as managers in charge, for ethically or legally questionable behaviors.

Failing to identify and manage conflicts of interest

When an individual has competing objectives a conflict of interest may arise and there may be an incentive to act opportunistically.

"In Southeast Asia, technological innovation is providing entirely new ways of doing established activities. Regulators in Indonesia, Singapore and Thailand are sponsoring various initiatives such as setting up FinTech 'regulatory sandboxes' to nurture innovation within the financial services industry. In addition, local banks are investing deeply, setting up new teams to drive innovation and partnering with technology players to develop solutions. To succeed, strong collaboration between these players in the ecosystem is key."

Thio Tse Gan, Southeast Asia Lead Partner, Centre for Regulatory Strategy, Deloitte

Figure 4: Drivers of misconduct (continued)

Complex, disconnected or "growth at all cost" businesses models

Silos develop where different cultures, behaviors and operational practices incubate. A sole focus on growth typically contain inherent conduct vulnerabilities.

Manual and complicated processes and procedures

Increase the chance of error and give people the incentive and opportunity to ignore controls.

Weak systems for monitoring and surveillance

Misconduct can go undetected, risks may not be appropriately managed and some individuals may be more likely to engage in poor behaviors because they estimate their chance of being discovered as low.

Disparate subcultures or a problematic prevailing culture

Failure to have a uniformity of culture established at the top of the house, underpinned by a single guiding business purpose, or a prevailing culture that does not balance short-term financial success with other important business and ethical imperatives.

Restoring trust

Industry, regulators and governments are designing ways to address the drivers of misconduct and raise standards within financial services firms, which in turn is helping to restore trust in the industry. Challenges, however, still remain.

Significant energy and resources are being invested by the financial services industry and its regulators to improve conduct. Addressing misconduct is one of the Financial Stability Board's (FSB) priorities and, to this end, the international body is pursuing "a major work programme" that has seen a working group set up to drive efforts and recommendations on reducing misconduct in the financial sector due for release in the first half of this year.[4]

The importance of embedding a good culture and cultivating good conduct is recognised as key in restoring reputational capital, retaining customers, building a sustainable business and maintaining a competitive advantage. This is perhaps even more pressing in the current environment where governments are looking for ways to augment and diversify competition in the financial services industry. Some of the responses to restoring trust are outlined in Figure 5.

4. Building a resilient and open global financial system to support sustainable cross-border investment," FSB Chair's letter to G20 Leaders, 30 August 2016. Link: http://www.fsb.org/wp-content/uploads/FSB-Chair%E2%80%99s-letter-to-G20-Leaders-in-advance-of-their-meeting-in-Hangzhou-on-4-5-September..pdf

Figure 5: Responses for restoring trust

Making customer needs and suitability central

Product governance and consumer protection obligations require products fit for purpose and acting in the customer's best interest. New training, mystery shopping, customer surveys/analytics are some responses.

Building balanced scorecards for HR decisions

Increased emphasis on an individual's ethical, compliance and regulatory history during the hiring process and refreshing recruitment, induction, training and development frameworks.

Ensuring individuals and leadership are responsible and accountable

Senior managers regime in UK, Yates Memo in US, Managers in Charge in Hong Kong and proposed public disclosure of details/names of those who have breached obligations in Australia.

Proactive identification and management of conflicts

Enterprise-wide reviews, enhancing information barriers, physically segregating teams and ensuring supervisory oversight.

Creating a cohesive organisation with a conduct-aligned business model

Governance, conduct and risk management frameworks have enterprise-wide penetration and direct lines to the executive. Business models reviews to make more customer centric. A holistic and forward looking regulatory approach.

Automating and streamlining processes and procedures

Process simplification, rationalisation, and optimisation so fewer, but better, rules. Change to the way processes and procedures are set. Leveraging technology to automate manual routine tasks.

Strengthening and modernising monitoring and surveillance

Enhanced requirements under legislations (e.g. MiFID, Dodd-Frank). Increase headcount or investing in sophisticated technology.

Defining and embedding a clear unified culture

Communications plans, socially-desirable purpose statements, embedding culture into risk management frameworks, regular Board discussion topic, training. Regulators are undertaking detailed reviews of firm culture.

Continuing challenges

Meeting regulatory requirements and expectations around managing conduct remains challenging for firms, particularly due to the proliferation of complex and onerous financial services regulation that has emerged since the financial crisis (and that continues to shift and evolve). In addition, compliance costs for a financial institution can be over $1bn every year and governance, risk management and compliance now represent an estimated 10-15 percent of the total financial services workforce.[5]

Overall, these significant investments in regulatory change programmes and compliance pose a challenge to profitability. And few organisations can provide evidence that their investments in improving culture and fewer misconduct incidents are helping with the bottom line. And this is when technology can make a difference.

A new approach through innovation

It is well established that innovation is disrupting the way that financial services are being provided to consumers. The focus is now being turned toward internal operations, with innovation being used to power better regulatory and compliance outcomes. The time is right to consider how new technologies can help manage conduct risk.

There is an expanding list of exciting technological advances and innovations that are driving disruptive innovation. In Figure 6, we explore some of the developments and technologies that offer the hope of significant efficiency and value gains by automating, simplifying and streamlining processes; integrating, aggregating and visualising vast volumes of structured and unstructured data; effortless customisation and scalability; enlisting self-learning machines to carry out intuitive tasks and real-time, possibly predictive and pre-emptive, systems replacing post-factum, reactive analysis.

Figure 6: A new approach through innovation

Ongoing assessment of customer needs and suitability

Visual network analytics to find data relationships relevant to customer needs (e.g., data integration, dynamic relationship mapping).

Customer value, customer segmentation, and customer satisfaction analytics.

Building balanced scorecards for HR decisions

Cognitive computing to analyse context, content and relationships within big data sets and to reveal critical trends and findings about an individual or across cohorts (e.g., from professional registers, performance reviews, customer feedback, complaints).

Streamlining and strengthening systems of accountability

Distributed Ledger Technology (DLT) to simplify record keeping, enhance transparency, robust time stamping and protection against manual change.

Automated enforcement of escalation procedures.

Proactive identification and management of conflicts

Master access control to set parameters and provide alerts.

Big data analytics and algorithms to map personal or business connections.

Cognitive technologies and predictive analytics to accelerate conflict scenario simulation and analysis.

5. Digital Economy Outlook," BBVA Research, February 2016. Link: https://www.bbvaresearch.com/wp-content/uploads/2016/02/DEO_Feb16-EN_Cap1.pdf

Figure 6: A new approach through innovation (continued)

Integrating systems and teams

API for interoperability and system communication.

DLT for a "single source of truth".

Mixed reality applications to improve communication and collaboration between remote teams and break down functional silos.

Automating and streamlining processes and procedures

RPA to automate routine processes.

DLT to strengthen against manual workarounds, reduce errors deriving from duplication and eliminate manual efforts required to perform data reconciliation.

Automating and modernising monitoring and surveillance

Machine learning algorithms to search and aggregate across multiple mediums.

NLP to automate communications monitoring.

Big data analytics and machine learning to predict future behaviours based on large-scale analysis of prior incidents.

Continual testing of cultural values

Big data analytics to scan patterns of behaviour across technologies and systems to surface potential vulnerabilities and model behavioural risk.

Real-time pulsing of staff, external partners and value chain participants.

The use of new technologies to fulfil regulatory and compliance requirements more efficiently and effectively is commonly referred to as "RegTech" (regulatory technology). Enlisting technology to help ease the burden of regulatory compliance is not new. However, the current buzz around RegTech is how the innovations and technologies that are transforming the way we provide financial services could also be harnessed to transform the way we go about meeting regulatory and compliance obligations.

It is certainly the right time for firms to explore and trial RegTech solutions. Technological innovation is providing entirely new ways of doing established activities. Regulators and organisations are sponsoring various initiatives to nurture innovation within the financial services industry. FinTech "hubs" and "regulatory sandboxes" are being set up to cultivate the growth of start-ups and provide a flexible regulatory environment in which applications of novel technologies can be road-tested. Industry is also investing deeply, setting up new teams to drive innovation, and partnering with technology players to develop solutions. Moreover, compliance costs are reaching unsustainable levels and not always producing desired results. Technology that can improve efficiency and value must be considered.

Conclusion

Expecting to eradicate misconduct incidents in financial services organisations is unrealistic, and hence the regulatory agenda continues to evolve its focus. Financial services organisations of all types are being expected to put in place a proactive framework to continuously identify and tackle poor conduct, and the role of technology cannot be ignored.

Designing the right conduct programme supported by the right technology solution starts by bringing together business, technology and regulation experts. Tapping into this collective pool of knowledge will best draw out the relevant conduct issues that undermine executing on strategy, and enable a bespoke and sustainable solution to be developed. By identifying the core drivers of misconduct, the ways that regulators and industry have sought to address these drivers, and the new technologies that can optimise responses we hope to have provided ideas for a strong foundation from which to build a conduct programme that will inspire trust.

The article is an excerpt of the report, "Managing conduct risk: Addressing drivers, restoring trust," developed by the Centre for Regulatory Strategy Asia Pacific. To receive a copy of the full report, drop us an email at sgindustries@deloitte.com.

Five things major financial institutions can do to harness disruption

Banks, insurers, and asset managers are struggling to keep their balance as they tackle three major fronts at once – simplifying the business, complying with regulations and modernising/differentiating themselves.

Over the last decade, regulatory expenditure has stifled spending on efficiency improvement and growth initiatives. The result is a downward spiral in which financial institutions are failing to invest in strategic capabilities on one hand, while increasing operational complexity on the other. The situation will likely become worse as nimble FinTech players increasingly disintermediate traditional financial service providers and their products, non-financial institutions start provisioning financial services and regulatory barriers are lowered, allowing competition in core areas from efficient start-ups.

Capitalising on disruptive technologies themselves can help the big players gain back their advantage. Innovation that is causing turmoil can also be exploited by financial firms to lower the cost of transformative change and to fund rapid, iterative modernisation. Some are taking "baby steps" in that direction today.

There are five things that financial services firms can do in order to harness disruption:

1. **Attack the most unwieldy costs:** Real-time, digital and highly automated business models offer the opportunity for wholesale "vaporisation" of high cost legacy infrastructures. In Deloitte's recent efforts, financial institutions surgically decimated highly inefficient business operations and earned savings of more than 50 to 60 percent by migrating processing to FinTechs. Regulatory compliance costs in particular deserve a fresh look as candidates for selective vaporisation. After almost a decade of unprecedented spending in response to the Dodd-Frank mandates and more, firms are saddled with point solutions that are hastily cobbled together and inefficient. Rethinking regulatory compliance in a business as usual context and re-architecting with agile, cloud and robotics may likely release much needed funds for modernisation and growth.

2. **Mutualise:** Financial institutions are individually running massive utilities, which are non-core to their businesses and could very easily be consolidated. Firms should up the ante around mutualising capabilities and associated costs with other players. While the number of effective industry initiatives in developing common reference data and processing utilities is on the rise, there is massive untapped potential especially given cloud, analytics and blockchain technologies. Intelligent, real-time utilities could readily provide efficiency improvements of 15 to 20 percent (if not more), while providing a high level of customisation for participants that was not attainable before. Taking this to another level, a related concept rapidly taking shape in the marketplace "collaborating ecosystems," in which firms – even competitors – integrate capabilities towards industry macro-processes. Ecosystems provide opportunity for streamlining the supply chain, achieving transaction volumes at scale and broader reach, along with greater cost mutualisation. Financial institutions need to web enable their capabilities in order to participate in this "API economy" as well as develop an ecosystem strategy to determine where and how to play.

3. **Harness disruptors for the last mile:** Top-down enterprise transformation initiatives like business process reengineering, business process management, workflow and data analytics help focus on optimising core business functions, but this leaves large gaps in coverage at end-points and in tactical processes. There are significant opportunities to improve efficiency that have been left on the table even with large enterprise investments. For example, a large financial services firm reengineered and digitized its Private Wealth business processes that yielded several strategic benefits. However, due to high demand for enterprise digital resources, about 5 percent of the processes that involved legacy, paper-based trusts were de-scoped. With an estimated 20M+ of paper trust documents, these processes remained a huge invisible contributor to inefficiency. There is a slew of mature digital technologies – automation, cognitive analytics, robotics, visualisation – that can be rapidly deployed at the end-user level to provide a significant boost in productivity at end-points. Unlike end-user technologies of the past, these tools allow for centralised governance and eliminate the risk for what is commonly known as "Shadow IT." In the example above, a cognitive OCR analytics solution is being developed to vaporise the inefficiency associated with paper records.

"The financial services industry is in flux: executives face complex regulations, increasing customer expectations, and competition from new technology enabled players. At the epicentre of change are the financial institutions. Leaders must be able to adapt, shape and harness the many disruptions that emerge in today's environment and this will require varying degrees of investment."

Ho Kok Yong, Financial Services Industry Leader, Deloitte Southeast Asia

4. **Extend digital all the way:** Evolved client digital expectation is driving efforts around interactive electronic interactions with clients. Time and budget pressures often lead to the tactical trap of creating workarounds in the back-end to build client-facing portals. Building truly end-to-end digital capabilities through streamlining the supply chain, creating process transparency and self service capabilities in conjunction with digital client portals could provide huge cost efficiency and better customer responsiveness.

5. **Manage the organisational transition:** Financial services firms are in the midst of a historic disruption driven by digital concepts that have already changed the landscape in retail and manufacturing industries. Getting to this future state will require disruptive reinvention, agility, and the need to run the financial services firm like a technology company. The building blocks will be the new workforce and a services-based, networked organisation with distinct accountability.

Despite the great appetite for transformation, financial firms seem to have continued to opt for tactical measures over the past decade since the case for change normally appeared prohibitive. Digital innovation has changed this equation, and firms should seize the disruptive advantage for themselves.

The article, written by Deloitte Principals Ashish Midha and Sachin Sondhi from New York was first featured in the "FSI Disruption Compendium," a series of insightful articles addressing key strategies to achieve the "new normal" in financial services. To receive a copy of the full report, drop us an email at sgindustries@deloitte.com.

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