FSIReview

Deloitte Southeast Asia
Financial Services Newsletter
Issue 10, August 2015

Winning the global regulation game
Building and sustaining competitive advantage

In this issue:

Foreword

Although the immediate ordeal of the financial crisis may be over, new and even more disruptive challenges are looming. Over the next few years, financial institutions are likely to experience a period of profound change in their external environment. The response to the crisis has been focused on increased regulations, changes to corporate structures and business models and the need to find new ways of improving profitability.

In this issue, we highlight a number of recent developments in the area of managing regulatory and risk compliance. As new rules are introduced and existing ones tightened, financial institutions are faced with a host of challenges in keeping abreast of these changes, and putting in place an effective and dynamic compliance framework which is responsive to the market and regulatory development.

We begin with the results of Deloitte's *Staying Ahead of the Pack* survey, revealing that contrary to the often-heard complaints from bankers on the increased cost from more compliance burdens, global financial services executives believe regulations have enabled business growth and they are expecting more to come.

We are also pleased to present the ninth edition of the Global Risk Management Survey, the latest instalment in Deloitte's ongoing assessment of the state of risk management in the global financial services industry. Financial institutions must not only comply with new regulatory requirements and priorities, they also need the flexibility to respond to the next round of regulatory developments that are likely to come over the coming years.

Next, we explore the impact of the Common Reporting Standard (CRS). Due to apply in 2016, the CRS will impose reporting obligations and exchange of information standards that will radically change the world of international tax planning.

Risk transformation can enable a financial institution to elevate risk management from a functional capability to an enterprise responsibility that pervades the entire organisation. At the cornerstone of risk transformation is the role of governance and culture, which can be relatively straightforward to define in risk policies, codes of conduct, and ethical guidelines, but extremely challenging to implement and maintain. We present the business case for transforming governance and culture: achieving business goals while avoiding problems.

We round things off with our *Asia Pacific Economic Outlook* for the second quarter, which provides a near-term outlook for Australia, the Philippines, Taiwan and Thailand.

As the industry continues to evolve, Deloitte's Financial Services Industry (FSI) Group is committed to providing insights on the issues most important to global financial institutions. Deloitte Southeast Asia's FSI practice aims to help guide our clients through challenging times and provide the insights that are required for success.

We hope you enjoy this edition of the FSI*Review*.

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In this issue

Staying ahead of the pack
How financial services firms are planning to win

“Financial institutions have taken a pragmatic and optimistic response towards regulatory changes. They’re taking on digital initiatives across a spectrum of operational areas, with an eye to profitability, compliance, and a superior client experience.”

Giam Ei Leen, Partner, Risk & Regulatory Advisory, FSI

Regulations in financial services has helped the industry to grow, contrary to the often-heard complaints from financial professionals on the increased cost from more compliance burdens.

According to the results of a Deloitte Touche Tohmatsu survey, 57% of global financial services executives believe regulation has enabled growth of their business. In addition, half of executives expect much more regulation in the near future, with 69% feeling prepared for it.

The survey of 200 executives at banking, securities, insurance and investment management firms around the world was conducted to identify the most important issues impacting the industry in the next three to five years. A quarter of respondents worked for firms with more than US$30 billion in revenue.

“Global financial firms are operating in an increasingly disruptive environment, with new entrants and fierce competition becoming the norm. Those that stay attuned to market needs and transform their business in anticipation of new entrants and disruptive trends will reap the greatest rewards,” said Chris Harvey, Deloitte Global Financial Services Leader.

“Today’s financial services field is highly dynamic. Financial institutions realise that compliance is not just about achieving regulatory outcomes and meeting customer expectations. When done right, it can be a significant competitive advantage that enables companies to realise strategic goals while improving profitability. To stay ahead of the competition, they will need a thorough understanding of the forces shaping the industry in order to harness them for growth,” added Ho Kok Yong, Deloitte’s Financial Services Industry Leader for Southeast Asia and Singapore.

Other key findings from the survey include:

- **Disruption is becoming the norm:**
  Nearly two-thirds of executives are seeing new entrants impact their industry segment.
- **Banking sector seeing more disruption:**
  Compared with the insurance sector, respondents in banking are 50% more likely to expect a major impact on their business from new entrants and disruptive trends.
- **Innovation is key:**
  82% of executives believe innovation is very or most important in their current environments.
- **Regulation varies by region:**
  Respondents in Asia and Europe were two times more likely than those in the Americas to expect a lot more regulation.
- **Areas deemed important for market success:**
  Ranked in order of priority, innovation and new offerings; digital transformation; regulations and talent needs are most important.
- **Human capital strategy key to success:**
  Talent retention (90%), right skills in the right location (85%) and talent governance (85%) are key strategies.

Areas to ensure market success, ranked in order of priority:

1 **Innovation & new offerings**

2 Digital transformation

3 Regulations

4 Talent needs

82% say that innovation is very or most important in their current environments.

Most say **regulations** have not stifled growth; **57%** say they've enabled growth.

Half expect much more regulation in the near future. Regardless of expectations, **69%** are prepared for it.

Nearly **2/3** are seeing new entrants impact their industry segment.

Compared with insurance, respondents in banking are **50% more likely** to expect a major impact on their business from new entrants and disruptive trends.

Respondents in Asia and Europe are **two times** more likely than those in the Americas to expect a lot more regulation.

Talent retention is very or most important to human capital strategy, say **90%** of respondents.

For full versions of our point-of-view, please visit our Financial Services Industry pages at at www.deloitte.com/fsi.

More than

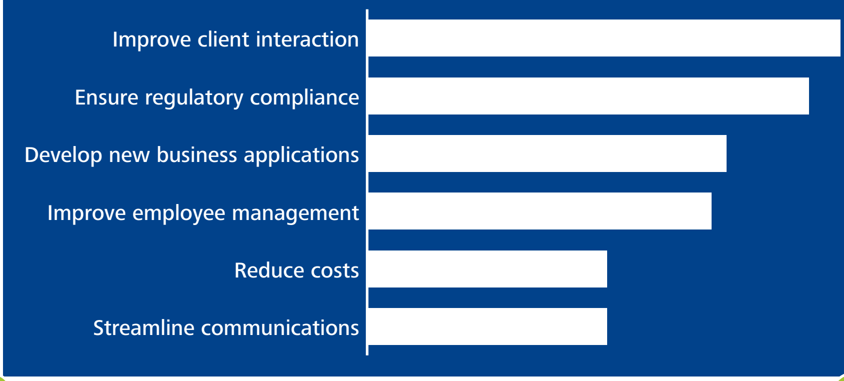
6 out of 10

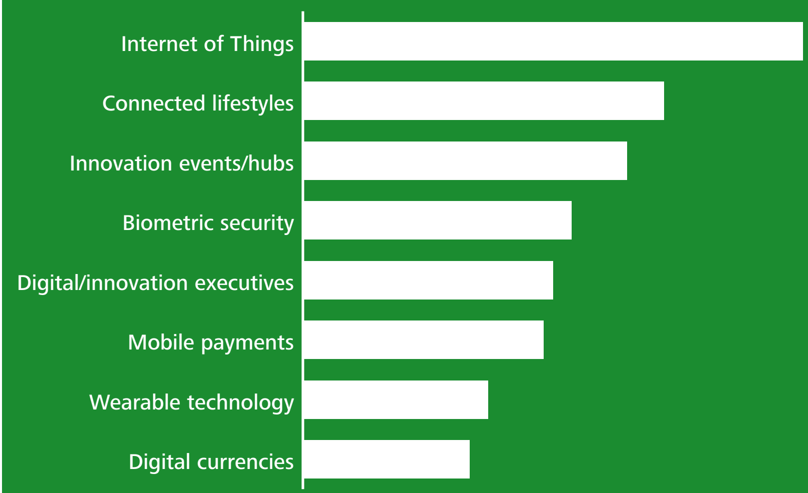
are innovating in operations.

Firms are seeking an advantage via

digital transformation

… cost is the #1 challenge.





On average, respondents believe the ‘Internet of Things’ will have the **greatest industry impact** – more than biometric security, mobile payments, or digital currencies.

Creating opportunities for skilled employees to exhibit talent is the **#1** way firms build internal meritocracies.

More than **2/3** use a formal structure to balance meritocracy reward systems with ethical governance.

On a 5-point scale, an ethical governance programme ranks **4.5.**

Global Risk Management Survey, Ninth Edition

Operating in the new normal: Increased regulation and heightened expectations

"In an age of heightened and evolving regulatory expectations, financial institutions must not only comply with regulations, but also find the flexibility to respond quickly and effectively to future regulatory developments. This will require strong risk management capabilities, robust risk infrastructures, and timely, high-quality risk data that are aggregated across the organisation."

Somkrit Krishnamra, Partner, Enterprise Risk Services, FSI

The global financial crisis was the catalyst for an era of sweeping regulatory change that shows little sign of abating. Across the financial services industry, regulatory requirements are becoming broader in scope and more stringent.

After new regulations are enacted, it can take years before their practical implications become clear. Although the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) in the United States and Basel III were introduced several years ago, their rules are still being finalised. New regulatory developments include the U.S Federal Reserve's Enhanced Prudential Standards (EPS), the European Central Bank (ECB) becoming the prudential supervisor of Eurozone banks, a new Banking Standards Review Council in the United Kingdom, and Solvency II becoming effective for European insurers in 2016.

The new regulatory landscape is placing demands on financial institutions in such areas as corporate governance, risk appetite, capital adequacy, stress tests, operational risk, technology data and information systems, and risk culture, to name only some areas of focus. As institutions prepare to comply, they will need the flexibility, in both their business models and compliance programmes, to respond to the seemingly inevitable next round of reforms.

Deloitte's global risk management survey, ninth edition assesses the industry's risk management practices and challenges in this period of re-examination. The survey was conducted in the second half of 2014 and includes responses from 71 financial services institutions around the world that operate across a range of financial sectors and with aggregate assets of almost US$18 trillion.

Key findings

More focus on risk management by boards of directors:

Reflecting increased regulatory requirements, 85% of respondents reported that their board of directors currently devotes more time to oversight of risk than it did two years ago. The most common board responsibilities are approve the enterprise-level statement of risk appetite (89%) and review corporate strategy for alignment with the risk profile of the organisation (80%).

Broad adoption of CRO position:

During the course of this global risk management survey series, the existence of a chief risk officer (CRO) position has grown to be nearly universal. In the current survey, 92% of institutions reported having a CRO or equivalent position, up from 89% in 2012 and 65% in 2002. Although it is considered a leading practice[1] for the CRO to report to the board of directors, only 46% of respondents said this is the case, while 68% said the CRO reports to the CEO[2]. In a positive sign, 68% of respondents said the CRO has primary oversight responsibility for risk management, an increase from 42% in 2012. Three responsibilities of the independent risk management programme led by the CRO were cited by more than 90% of respondents: develop and implement the risk management framework, methodologies, standards, policies, and limits; oversee risk model governance; and meet regularly with board of directors or board risk committees. Yet only 57% of respondents said their risk management programme had the responsibility to approve new business or products.

ERM becoming standard practice:

It has become a regulatory expectation for larger institutions to have an enterprise risk management (ERM) programme, and this is reflected in the survey results. 92% of respondents said their institution either had an ERM programme or was in the process of implementing one, an increase from 83% in 2012 and 59% in 2008. Another positive development is that among these institutions, 78% have an ERM framework and/or ERM policy approved by the board of directors or a board committee.

Progress in meeting Basel III capital requirements:

89% of respondents at banks subject to Basel III or to equivalent regulatory requirements said their institution already meets the minimum capital ratios. The most common response to Basel III's capital requirements was to devote more time on capital efficiency and capital allocation (75%).

Increasing use of stress tests:

Regulators are increasingly relying on stress tests to assess capital adequacy, and respondents said stress testing plays a variety of roles in their institutions, including enables forward-looking assessments of risk (86%), feeds into capital and liquidity planning procedures (85%), and informs setting of risk tolerance (82%).

Low effectiveness ratings on managing operational risk types:

Roughly two-thirds of respondents felt their institution was extremely or very effective in managing the more traditional types of operational risks, such as legal (70%), regulatory/compliance (67%), and tax (66%). Fewer respondents felt their institution was extremely or very effective when it came to other operational risk types such as third party (44%), cybersecurity (42%), data integrity (40%), and model (37%).

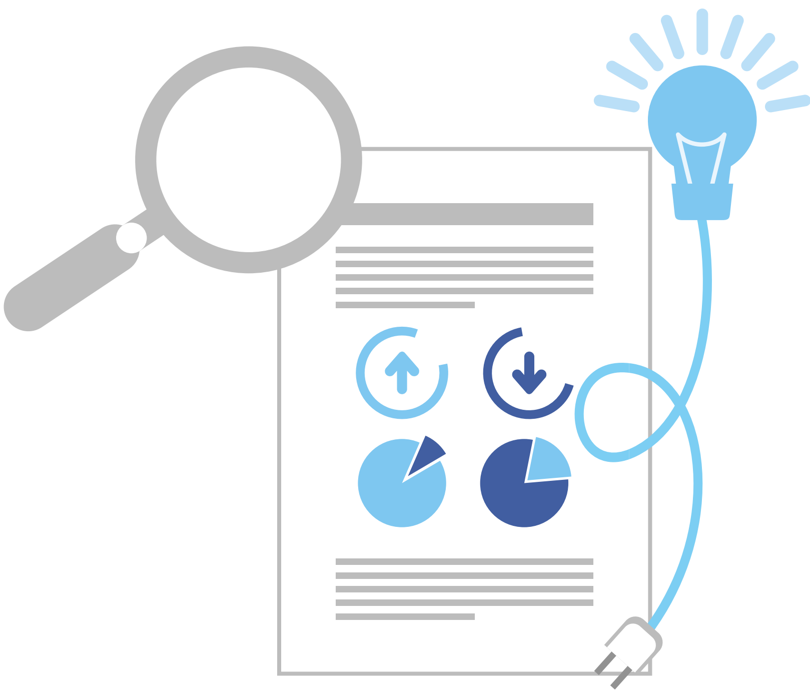
1 *About the term "leading practice": For purposes of this paper, we consider industry practices to fall into a range, from leading to lagging. Some industry practices may be considered leading practices, which are generally looked upon favourably by regulators, industry professionals, and observers due to the potentially superior outcomes the practice may attain. Other approaches may be considered prevailing practices, which are seen to be widely in use. At the lower end of the range are lagging practices, which generally represent less advanced approaches and which may result in less-than-optimal outcomes. Items reflected as leading practices herein are based on survey feedback and the editor's and contributors' experience with relevant organisations.*

2 *Percentages total to more than 100% since respondents could make multiple selections.*

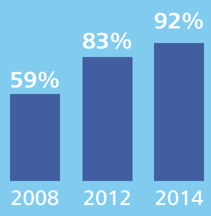
More attention needed on conduct risk and risk culture:
There has been increased focus on the steps that institutions can take to manage conduct risk and to create a risk culture that encourages employees to follow ethical practices and assume an appropriate level of risk, but more work appears to be needed in this area. 60% of respondents said their board of directors works to establish and embed the risk culture of the enterprise and promote open discussions regarding risk, and a similar percentage said that one of the board's responsibilities is to review incentive compensation plans to consider alignment of risks with rewards, while the remaining respondents said these were not among the board's responsibilities. Only about half of respondents said it was a responsibility of their institution's risk management programme to review compensation plan to assess its impact on risk appetite and culture.

Increasing importance and cost of regulatory requirements:
When asked which risk types would increase the most in importance for their institution over the next two years, regulatory / compliance risk was most often ranked among the top three, and 79% felt that increasing regulatory requirements and expectations were their greatest challenge. The most important impact of regulatory reform was noticing an increased cost of compliance, cited by 87% of respondents.

Risk data and technology systems continue to pose challenges:
Again in 2014, the survey results indicated a need for continued improvement to risk data and information systems. 62% of respondents said that risk information systems and technology infrastructure were extremely or very challenging, and 46% said the same about risk data. Issues related to data quality and information systems were also considered by many respondents to be extremely or very challenging in complying with Basel III (56%) and Solvency II (77%), and in managing investment management risk (55%). Going forward, 48% of respondents were extremely or very concerned about the ability of the technology systems at their institution to be able to respond flexibly to ongoing regulatory change.



The era of sweeping regulatory change that began following the global financial crisis shows little sign of abating; across the financial services industry, regulatory requirements are becoming broader in scope and more stringent. Against this backdrop, financial institutions continue to make progress in many areas of risk governance and risk management . . .



92% of 2014 respondents indicated their institution has an enterprise risk management programme in place or is in the process of implementing one, up 33% since 2008.

85% of respondents reported that their board of directors regularly devotes more time to oversight of risk than it did two years ago.

The prevalence of the CRO position continues to grow:

75% of 2014 respondents reported that their institution has a written enterprise-level statement of risk appetite that has been approved by the board of directors, up from two-thirds in 2012.

Employed at **94%** of responding institutions in the 2014 survey, the "three lines of defense" risk governance model has become very widely adopted.

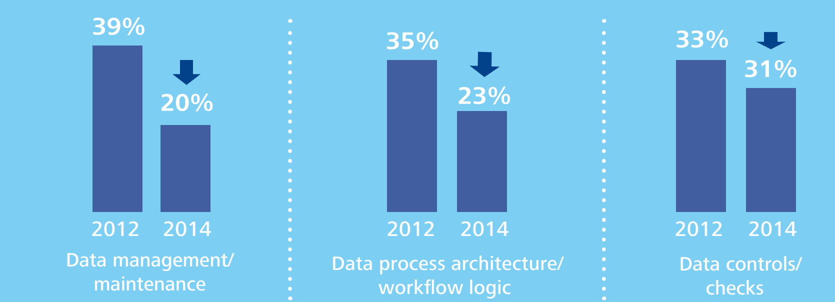
That said, our survey results also indicate a number of areas where challenges continue and continued close attention is warranted.

Although up from 2012 results, it was somewhat surprising that **ONLY 63% OF RESPONDENTS** said their board of directors or board risk committee reviews incentive compensation plans to consider alignment of risk with rewards, particularly given regulators' increased focus on conduct risk, risk culture, and ethical standards.

ONLY 60% OF RESPONDENTS said their boards of directors work to establish and embed the risk culture of the enterprise and promote open discussions regarding risk, while the remaining respondents said these were not among the board's responsibilities.

79% of respondents cited "increasing regulatory requirements and expectations" as being extremely challenging or very challenging.

Although institutions are doing better in risk data and infrastructure than they were in 2012, significant work remains to be done to bring technology systems in line with stricter regulatory requirements for accurate, timely, consistent risk data aggregated across the enterprise. Percent reporting "effective/very effective":



Source: Deloitte University Press, 2015 | DUPress.com

For the full report, please visit our Financial Services Industry pages at at www.deloitte.com/fsi. For more economic and business research, visit Deloitte University Press at www.dupress.com.

FATCA and Common Reporting Standard
Reflecting on FATCA as we move forward with CRS

This article was contributed by Michael Velten, Partner, Tax, FSI.

Currently over 90 jurisdictions have committed to the Organization for Economic Co-operation and Development (OECD) Common Reporting Standard (CRS) for the automatic exchange of information between tax authorities of signatory countries. The first information exchange is due to happen as soon as 2017 for 58 "early adopter" jurisdictions.

In Asia, India and South Korea are early adopters. The current list of "non-early adopters" in the region includes Brunei Darussalam, Indonesia, Malaysia and Singapore, with the first exchange of information due to happen in 2018.

Signalling a key step towards implementing the CRS, 61 countries have already signed the Multi-lateral Competent Authority Agreement (MCAA). In the region, India, Indonesia and South Korea have signed the MCAA to date. Australia has also signed the MCAA[3].

The technical differences between CRS and FATCA result in varying operational impacts. Furthermore, differences in the definitions and requirements under the two regimes mean that it will be difficult for impacted financial institutions to simply leverage the work from FATCA for CRS. The diagram below illustrates some of these differences.

Main differences and similarities between CRS and FATCA

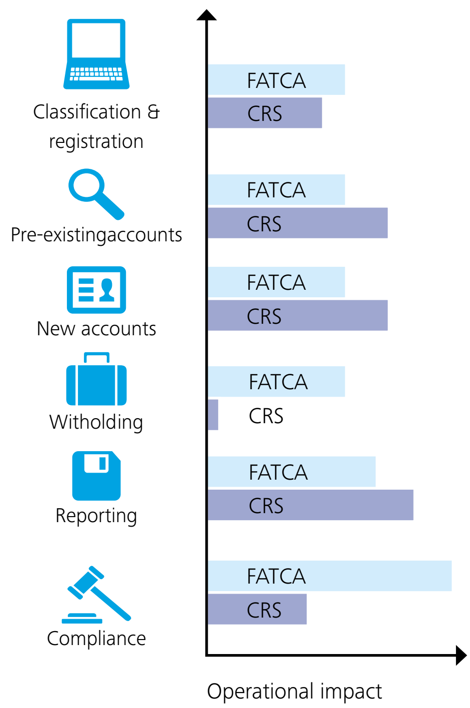
CRS is based on the Intergovernmental Agreements (IGAs) for the implementation of the Foreign Account Tax Compliance Act (FATCA) and, broadly, both CRS and FATCA impose compliance obligations on financial institutions to:

- Classify entities and products
- Identify and document pre-existing and new account holders
- Report information to tax authorities

But there are a number of differences between CRS and FATCA. The two key differences to FATCA are that:

- The OECD has stripped out the U.S. centric aspects of FATCA to achieve a global standard, so that certain exclusions, exemptions and thresholds are not part of; and
- Reportable accounts for CRS are determined by tax residency, which can be a more complex question than the U.S. person test for FATCA.

Figure 1: Differences between FATCA and CRS



- No central registration for CRS (such as via IRS FATCA-portal); potentially domestic registration under CRS
- No globally uniform identification for financial institutions (such as GIIN)
- Certain non-reporting entities and excluded products for FATCA may be in scope for CRS

- Potentially conflicting indicia indicating residence in multiple jurisdictions
- Population of accounts concerned much larger for CRS

- Determination of tax residence is more complicated than U.S person test
- No waivers required for CRS

- No withholding imposed under CRS
- CRS may be linked with TRACE in future

- Number of accounts to be reported increases significant for CRS
- Type of information to be reported mostly consistent
- Reporting via domestic tax authorities

- No responsible office concert foreseen (rather domestic audits)
- No group compliance required for CRS

[3] *See: http://www.oecd.org/tax/exchange-of-tax-information/MCAA-Signatories.pdf*

Reflecting on the lessons learned from FATCA

Financial institutions across Southeast Asia have already invested, and continue to invest significant time and resources implementing FATCA. As we pass the close of the first year since FATCA implementation commenced, many are now reflecting back on the past year to evaluate how the implementation of FATCA has fared, and what lessons they have learnt as they start to prepare for the CRS.

Outlined below are five key lessons we have identified based on the current status of the FATCA implementation by financial institutions across the region:

- The devil is in the detail of technical regulations and guidance, and also organisational information. A detailed understanding of both correlated led to a more thorough FATCA impact analysis;
- A strong governance framework supported by documented roadmaps and defined roles and responsibilities was more successful;
- The data can make or break you, from the volume and quality of data to allocating sufficient resources to analyse the data in the required timeframe;
- Identifying the legal and regulatory 'Dos and Don'ts' as early as possible allowed sufficient time for changes to be made; and
- Collaborative communication with business units and other financial institutions created efficiencies, drove a higher standard truer to the objectives of the rules and reduced adverse impacts on the customer experience.

"While there is still a focus on FATCA, financial institutions are encouraged to start to prepare now for CRS as differences in the definitions and requirements under the two regimes mean that financial institutions will be unable to simply leverage the work from FATCA for CRS. Operational complexities when implementing the CRS requirements should be expected."

Michael Velten, Partner, Tax, FSI

Preparing for your next step

While the first CRS reporting may seem some time away, financial institutions in the region are encouraged to start to prepare now. Once the FATCA reporting for 2015 is complete in the region, it is likely that there will be a swift move towards the CRS.

Preparatory activities should include:

- Ensuring that information about products, systems, processes and data collected for FATCA is available to be recycled for the CRS implementation;
- Making strategic decisions on the implementation approach for the CRS – such as dealing with different start dates in different locations in which a multinational group may be based and whether to adopt a wider approach or phased-in approach;
- Participating in consultation and development of the law and guidance. The CRS is a global standard, but it is implemented through domestic legislation and guidance. So financial institutions in their respective jurisdictions can influence exclusions and exemptions, as well as ways to determine tax residency and classify account holders;
- Developing client and employee communication and information, taking into account cultural and language considerations; and
- Reviewing the data landscape, including information and data privacy constraints.

Over the next few months, financial institutions should:

- Become familiar with the CRS and its commentary;
- Get involved in consultation through the relevant industry body as and when the industry in the respective jurisdiction starts to consult;
- Set up a CRS project team that includes resources from FATCA and anti-money laundering (AML) / client due diligence (CDD) teams;
- Undertake a FATCA post-implementation review and gap analysis to assess the base for CRS implementation; and
- Start drafting requests for changes to technology, on boarding forms and processes.

For more information on how FATCA and the CRS might impact your organisation, please contact our FSI Tax team at enquiries@deloitte.com.

Implementing risk transformation in financial institutions

The role of governance and culture

The following is an extract from a Deloitte point-of-view report on the role of governance and culture in implementing risk transformation in financial institutions.

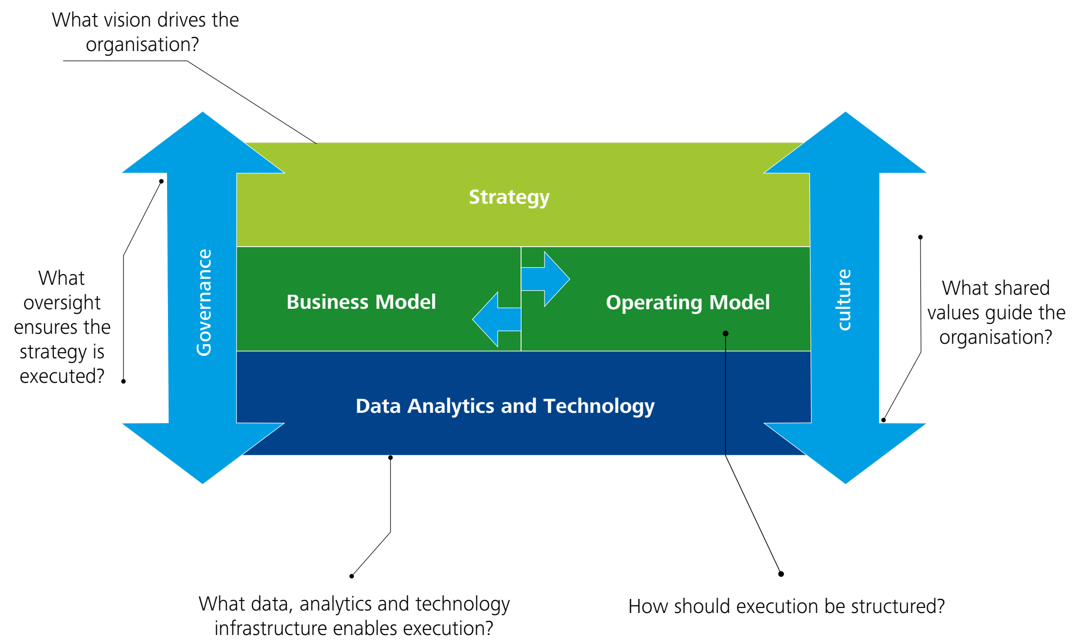
> "To implement a strategy, leaders must consciously foster a culture that will support achievement of the strategy. Risk culture calls for clarity at the leadership level, at the business unit and functional levels, and in individual roles and responsibilities. It is management's role and responsibility to provide that clarity."

Thio Tse Gan, Executive Director, Enterprise Risk Services, FSI

Risk transformation can enable a financial institution to elevate risk management from a functional capability to an enterprise responsibility that permeates the entire organisation. When the frameworks and capabilities of each of the four cornerstones of risk transformation – strategy; governance and culture; business and operating models, and data, analytics, and technology – are in place, risk management, risk governance, and regulatory compliance can be implemented in a more aligned and integrated manner.

Only with the right risk culture can management effectively implement its business strategies and objectives. Governance provides mechanisms that assist management in shaping organisational risk culture. The business and operating model, and a firm foundation of data, analytics, and technology, also play significant enabling roles in risk transformation.

Figure 2: The cornerstones of risk transformation



Governance and culture as a cornerstone

In the past several years, virtually all major financial institutions have been working to strengthen their risk governance practices and risk culture. These continuing efforts have sought to address lapses in conduct and enhance controls, while enabling organisations to respond to new regulatory demands and increased scrutiny of risk governance, risk management, and operating cultures.

In addition, significantly increased regulatory capital and liquidity requirements are forcing financial institutions to stress capital efficiency in their strategies and objectives and, in particular, to reconfigure business models to emphasise those that are less capital-intensive. Transforming this cornerstone supports movement from business models based on high capital leverage, to those based on enhanced capital efficiency and lower leverage.

Governing risk

The Deloitte risk governance framework centres on risk with board governance as the overarching activity. The central relationship between risk and culture is depicted in the 'culture' pyramid around risk. Risk governance, a dimension of corporate governance, includes, among other things:

- Risk oversight
- Risk appetite and risk limits
- Risk capacity
- Risk monitoring and reporting
- Risk-related roles, responsibilities, and authorities

These elements should inform the ongoing interactions between the board and management and the organisation's risk culture.

Sound risk governance encompasses risk-related committees, policies, processes, and practices, and fulfils their intent in activities such as monitoring risk exposures, challenging risk-related decisions, escalating risk issues to higher levels, and reporting on risk.

Sound risk governance goes hand-in-hand with a strong risk culture. By the same token inconsistent, incomplete, or pro forma risk governance goes hand-in-hand with a weak risk culture.

Figure 3: Deloitte risk governance framework

Culture rules

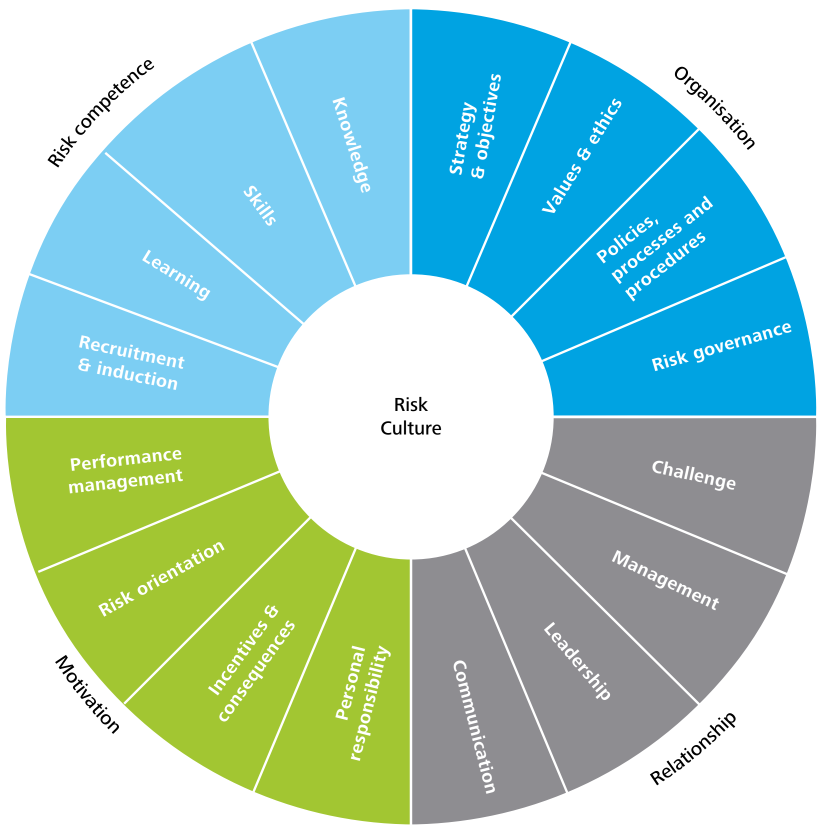
In the Deloitte risk governance framework, culture stands at the centre - with risk - in that the two need to be tightly intertwined within a financial institution's modus operandi.

Given that culture usually determines conduct, failures in risk culture are frequently characterised as conduct failures, with the term conduct risk now being widely used. Leaders have sought to review and strengthen their risk cultures because culture determines conduct. The Deloitte risk culture framework can assist these efforts.

Risk culture can be assessed along 16 attributes, related to four determinants: organisation, relationships, motivation, and risk competence. Once the risk culture is understood, elements of it that require strengthening can be identified.

Leaders should be wary of and avoid strategies that cannot be implemented given the prevailing culture and an inability to change it. What constitutes a sound risk culture will vary among and within institutions. Some organisations will select strategies, goals, customer segments, and product lines that are inherently more risky or less risky. This is as it should be, given the range of customer needs and paths to creating value. However, leaders must consciously choose productive strategies within the risk appetite and then establish an enabling culture.

Figure 4: Deloitte risk culture framework



Deloitte risk culture framework

- **Risk competence** The collective risk management competence of the organisation
- **Motivation** The reasons why people manage risk the way that they do
- **Relationships** How people in the organisation interact with others
- **Organisation** How the organisational environment is structured and what is valued

Changing risk culture

Evolving business issues will continue to demand cultural change in financial institutions. The following guidelines can assist management in fostering cultural change:

- **Start from a baseline:**
  Risk culture can be measured using indices of the attributes shown in Figure 3 and of other attributes that may pertain to the organisation, such as collective focus, shared beliefs, inclusion, and commitment. In addition, perceptions of governance and compliance, willingness to challenge decisions and to escalate and act on emerging risks, and ability to accommodate and address geo-cultural differences can be assessed. A baseline assessment measures key attributes and identifies levers of change.

- **Work across the enterprise:**
  It's easy to think of risk culture as monolithic or to imagine a single organisational risk culture. However, because risk culture will and often should vary with the nature of a business and its strategy, location, and regulatory environment, management must be attuned to these factors. Then leaders must design, implement, and maintain the type of risk culture suited to the organisation as a whole and to its specific business units' objectives and risk appetites.

- **Establish a common purpose:**
  People need clarity regarding approaches to risk, compliance roles and responsibilities, and customer needs all in the context of creating shareholder value. Establishing a common purpose goes well beyond issuing a corporate mission statement. It extends to instilling and sustaining a common purpose in employee on-boarding and training, performance evaluations and compensation systems, and management's conduct and decisions.

- **Maintain a consistent tone:**
  Risk culture begins at the top, with consistently communicated and reinforced values, beliefs, and conduct among the leadership team. To establish tone at the top, the board and management must be clear among themselves regarding strategy, business and operating models, acceptable risks, and approaches to risk governance and compliance. They must promulgate this tone throughout the organisation at every level. Breakdowns often occur with "tone in the middle" when leaders send faint signals or mixed messages down the ranks. If tone breaks down in the middle, a weak risk culture will frequently prevail, particularly among front-line personnel.

- **Monitor the culture going forward:**
  Absent strong leadership and sustained effort, the risk culture of the business units, functions, and institution will, over time, inevitably weaken. As a result, middle managers and employees may individually interpret what is in the customer's or organisation's interests or feel they are 'on their own' when it comes to risk. Strong leadership and sustained effort are exerted through consistent, conscious use of cultural levers and periodic monitoring of risk culture metrics and performance indicators against baseline and updated values.

Conclusion

As a cornerstone of risk transformation, governance and risk culture can be relatively straightforward to define in risk policies, codes of conduct, and ethical guidelines, but challenging to implement and maintain.

Risk governance establishes roles, rules, and parameters and instils rigor in decisions and activities. Risk culture focuses on social, motivational, and real time pressures, which can be resistant to change through governance alone; however, governance does much to inform and shape risk culture. From a leadership standpoint, conscious alignment between risk governance and risk culture is an imperative for risk transformation.

It is believed that financial institutions that do the best job of managing risk will secure a competitive advantage vis-à-vis their peers. Therefore, in the current business, economic, and regulatory environment, risk transformation should stand as a high priority. Governance and culture represent a key cornerstone and an excellent starting point for a risk transformation initiative.

For the full report, please visit our Financial Services Industry pages at www.deloitte.com/fsi.

Asia Pacific Economic Outlook, Q2 2015
Australia, the Philippines, Taiwan and Thailand

The latest quarterly edition of Deloitte's *Asia Pacific Economic Outlook* from Deloitte University Press provides a near-term outlook for Australia, the Philippines, Taiwan and Thailand. As the report notes, Australia faces slowing growth; the Philippines is entering 2015 on a high; Taiwan is in the shadow of China; and Thailand's economic recovery depends on its internal stability. The following are excerpts from the full report.

Australia:

Growth to limp through 2015. Australia's economic growth slowed further in Q4 2014 to 2.3% year over year, in contrast to 2.7% in the previous quarter. Annually, the country's GDP grew at a below-trend pace of 2.5% in 2014. The momentum of national income growth slowed in the second half due to lower export prices for iron ore and coal. However, the strong investment in new capacity made in recent years is now coming on-stream, meaning that export volumes remain the main contributor to economic growth. On the other hand, domestic demand remained weak throughout the year due to poor consumer and business spending. While a weak labour market, record-low wage gains and high household debt weighed on consumption expenditure, sliding commodity prices and poor domestic demand resulted in weakening business investment.

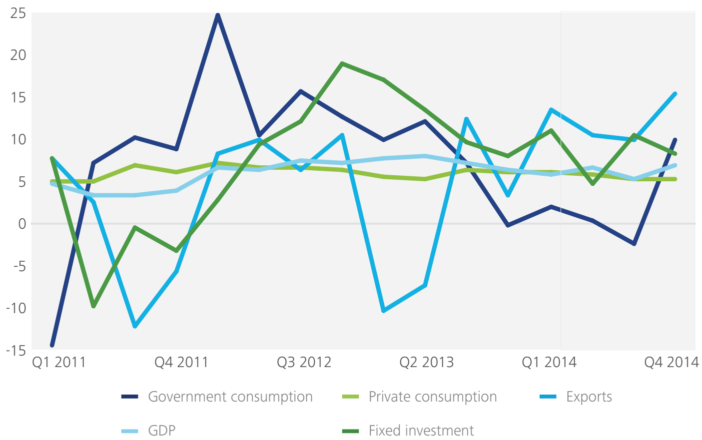
The underlying labour market conditions remained soft, as evident from the rising unemployment rate, which increased to 6.3% in February the highest in 13 years. Employers have been reluctant to employ permanent employees as they remain sceptical about economic growth prospects. On the positive side, weaker domestic demand, poor wage growth, the abolition of a carbon tax, and low international oil prices resulted in low inflation. Inflation was 1.7% in 2014 through Q4 compared with 2.3% in Q3 2014. At the same time, the average value of the Australian dollar depreciated 6.5% in 2014.

Philippines:

Entering 2015 on a high. For a long time, the Philippines was in the shadow of some of its more illustrious neighbours in Southeast Asia. Poverty, poor infrastructure and workers migrating to greener pastures abroad had left the economy stranded. But things started changing in the past decade, especially the last few years; between 2010 and 2014, real GDP expanded on average 6.3% every year. The positive momentum is likely to continue in the medium term as policymakers try to set the foundation for sustainable manufacturing and services activity. Aiding the economy will be continued large remittances from overseas Filipino workers. At last count, there were about 10 million of them.

Real GDP grew 6.9% year over year in Q4 2014, up from 5.3% in Q3. This took annual GDP growth in 2014 to 6.1%, yet another year of strong economic growth in a challenging global environment. Growth in Q4 2014 was primarily driven by exports, government expenditure and private consumption (Figure 1). Total exports grew 15.5% in Q4, up from 9.9% in Q3. External demand will remain healthy in 2015 as well, with a strong U.S. economy likely to offset the impact of a slowing China and a weak Eurozone. Government consumption grew 9.8% in Q4 2014, a reversal from the 2.8% decline in Q3. Spending had slowed in previous quarters as legal challenges resulting from allegations of corruption had hampered the allocation of contracts. This seems to have changed in Q4, and it is a positive development, given the need to improve infrastructure.

Figure 5: GDP growth continues to be strong in the Philippines



Source: Oxford Economics; Deloitte Research economic analysis.

Graphic: Deloitte University Press | DUPress.com

Taiwan:

In the shadow of China. Taiwan's economy faces contradictory influences. On the one hand, lower oil prices are having a positive impact on consumer purchasing power, thus boosting domestic demand. On the other hand, the worsening condition of the Chinese economy is hurting Taiwan's exporting prowess although improvements in the U.S. and European economies have the potential to provide a positive offset.

First, consider oil. It accounts for roughly 10% of Taiwan's imports. The price of oil has fallen more than 50% in the past year, thus providing Taiwan with both lower inflation and increased purchasing power[4]. As of February 2015, consumer prices in Taiwan were down 0.2% from a year earlier, mimicking the deflation that many developed economies are now experiencing due to declining energy prices. At the same time, wages have been rising due to a relatively tight labour market. The unemployment rate is now 3.8%. Thus the real purchasing power of households is expanding, boding well for a strong increase in consumer spending in the coming year.

Next, consider the impact of China's slowdown. China and Hong Kong purchase almost 40% of Taiwan's exports. Meanwhile, the United States and European Union account for nearly 20% of Taiwan's exports. The Chinese economy has slowed considerably and continues to decelerate. Growth this year is expected to be the lowest in a generation. This is likely to have a chilling effect on the volume of Taiwanese exports to China.

Thailand:

Economic recovery depends on internal stability. 2014 was a difficult year for Thailand's economy. Tourist numbers fell due to political tension, manufacturing declined and private consumption remained subdued. Economic growth for the year on the whole was down to 0.7% from 2.9% in 2013.

However, a recent rebound in tourism, along with the low price of oil, is expected to initiate an economic recovery. The strength and sustainability of recovery will depend upon how Thailand addresses its problems: high household debt, imminent drought in certain provinces, weakness in Thailand's key export markets (China, Japan and the European Union), and military rule, which could hurt the prospect of political stability.

Real GDP grew 2.3% year over year in Q4 2014. Government consumption expenditure grew 5.5%, picking up from 0.4% in Q3. This is in line with the military administration's plan to increase fiscal spending. However, household consumption expenditure remained weak, decelerating to 1.9% from 2.2% in Q3. This was mainly because of high household debt and a 1.6% contraction in the agricultural sector in Q4. Because approximately 40% of Thailand's labour force is employed in agriculture, weak growth in this sector translates into weak consumption expenditure.

Gross fixed capital formation grew 3.2% from a year ago. Total investment was driven by private sector investment, which grew 4.1% on the back of a recovery in private construction and investment in machinery and equipment. On the other hand, public investment declined 0.3% in Q4 even though public construction grew 5.1%.

Read the full Asia Pacific Economic Outlook, Q2 2015 on www.dupress.com to learn more about short-term economic outlook for Australia, Philippines, Thailand and Taiwan.

[4] *All data in the article about Taiwan come from Oxford Economics, "Country economic forecast, Taiwan," March 2015.*

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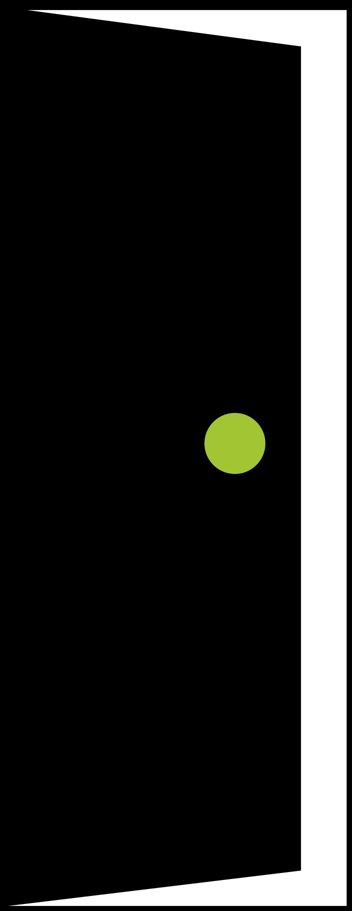

Opportunities lie ahead

Increasing globalisation and new investments in Southeast Asia, together with regional and local regulations, continue to put pressure on financial institutions. More than ever, companies need to reassess their strategic priorities and make choices to stay ahead. Success will depend on their ability to keep pace with the growth of emerging markets and to design new business models and partnerships to tackle relevant markets, key client segments and adapt their services.

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