FSI*Review*

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Digital disruption in financial services
The innovation imperative

In this issue:

Deloitte.

Foreword

Rapidly advancing technologies, evolving customer expectations and a changing regulatory landscape are opening doors to disruptive innovation in financial services. From crypto-currencies to big data to peer-to-peer lending, financial technologies (FinTechs) innovations have captured the attention and imagination of customers, investors and incumbents.

Disruptive innovation is here to stay, creating clear threats to the traditional structure of the financial world, but also opportunities for positive change and growth. The challenge: the financial services industry is struggling to understand which innovations will be the most relevant, as well as figuring out the evolutionary path of emerging innovations and the specific implications of those evolutions on existing institutions.

In this issue, we reflect on and emphasise the current digital disruption the industry is facing. We begin with highlights from our recent study with the World Economic Forum where we spent a year working as a project advisor examining the impact of innovation on multiple aspects of financial services.

Next, we examine the financing, banking and payment issues small and medium-sized enterprises (SMEs) in Southeast Asia face and how incumbent/challenger banks, FinTechs and e-commerce providers are seeking to fill the SME financing gap by adopting innovative business solutions.

Regulation continues to be a hot topic in the industry and has emerged as a major strategic consideration for financial services firms. While many reforms have been completed, our review of the current regulatory agenda indicates that it will remain full in coming years. We summarise the key elements of the current international reform agenda and highlight the application of these in the Asia Pacific region, organised around the major work-streams of the Financial Stability Board (FSB).

We also outline the challenges faced by private banks in Asia as they are increasingly burdened by risk and regulatory requirements and provide tips to effectively deliver private banking risk and regulatory transformation.

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

As the industry continues to evolve, Deloitte's Financial Services Industry 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*.

Ho Kok Yong
Partner and Southeast Asia Leader
Financial Services Industry
Tel: +65 6216 3260
Email: kho@deloitte.com

In this issue

What financial services leaders need to know about disruptive innovation

This article – written by Rob Galaski, Leader of Banking & Securities practice at Deloitte Canada – first appeared in the October 2015 issue of Deloitte's Inside Magazine; Southeast Asia commentary provided by Mohit Mehrotra, Strategy Consulting Leader at Deloitte Southeast Asia.

"When we look at the disruptive potential of innovation, we should not only consider the threats, but also the tremendous opportunities to reinvigorate our industry and become more relevant for our customers. Ultimately, the companies that emerge victorious are those that embrace innovation. Banks and insurance firms are already starting to see the effect of disruptors, and we believe much more is to come."

Ho Kok Yong, Southeast Asia FSI Leader

Deloitte[1] recently partnered with the World Economic Forum (WEF) to conduct a study to examine ways that disruptive innovations were reshaping the business of financial services. As part of that study, we consulted with a broad swath of established institutions, financial services start-ups, academic scholars and industry observers.

What we discovered led us to the following conclusions:

Almost every service is being disrupted
Innovation is reshaping nearly every aspect of financial services. The technologies bringing us the connected lifestyle are leading to intense personalisation in insurance, making the customer's "walk away cost" higher than ever before. Robo-advisors and social trading platforms are democratising investment management, eroding the mass affluent market while signalling a return to white glove advisory services.

In banking and securities, alternative providers are poised to take over the customer relationship. Cash and (quite possibly) credit cards are giving way to digital alternatives that will cost financial institutions at least some influence over the transaction experience. Distributed capital raising platforms are opening up the capital markets, forcing traditional intermediaries to develop new value propositions in order to compete.

Southeast Asia highlights
In Southeast Asia, we are also witnessing several disruptions across the financial services spectrum. The disruption is more pronounced in 'payments' and within the 'credit intermediary' space. In comparison, there are relatively fewer FinTechs in capital markets and wealth management.

Disruption in payments is interesting as there are FinTechs challenging the incumbents across retail and SME banking. In retail, there are FinTechs that are making a push in social payments and remittances. On the other hand in SME banking, FinTechs are targeting the payables and receivables flows through nimbler and technology-based offerings.

[1] As used in this article Deloitte refers to Deloitte Touche Tohmatsu Limited and its member firms.

You can see the innovators coming

In financial services, innovation is occurring in clusters. But the clusters are forming around potentially profitable customer segments that are well known to be underserved in some way. In other words, innovators are addressing the same opportunities that incumbent institutions have identified. The next wave of change is deliberate and predictable.

What's more, successful innovators are more alike than not. Many are marketplace platforms rather than new institutions. They don't require a great deal of capital and they make significant use of data collection, sharing and analytics. Because of this business model, innovators are at least as likely to be customers or partners of traditional financial institutions as they are competitors of them.

Southeast Asia highlights

FinTech development in Southeast Asia is still in the early stage as compared to the West. Globally, it is estimated that there are 12,000 FinTechs operating today. Currently, Southeast Asia has a low proportion of this pie but we expect this to change as countries put in place the supporting environment for FinTechs to grow.

We are already seeing incumbent financial institutions in the region looking at how they can collaborate and partner with FinTechs. This is especially true in certain niche areas where the incumbent is of the view that working with a FinTech could significantly enhance its competitive advantage or help it target certain customer segments better.

Some are already feeling the impact

Retail banking is the first to have been hit with disruptive innovation. In the payments arena, mobile applications free users from their wallets and the checkout line. Integrated and streamlined technologies make it easier to settle accounts. Geotagging, biometrics and tokens protect all parties to a transaction from fraud.

Meanwhile, the lending business is becoming increasingly virtual. Thanks to improved technology, direct banks—ones with no brick-and-mortar branches, only ATMs—can compete on more than just price. Other non-traditional players are offering mobile users conveniences such as peer-to-peer money transfer, photo bill payment and voice recognition.

But insurance is where disruption will be felt hardest. Already cars have operating systems, run user-installed apps, and connect to the Internet. People manage their health through wearable devices that communicate potential issues to healthcare professionals. Devices monitor the home and pick up risk factors requiring preventive action. The old ways of measuring customer risk are quickly becoming irrelevant.

Southeast Asia highlights

Unlike in China, the impact has not been felt at-scale in Southeast Asia yet due to the early stage of development. Most of the innovations today are in niche areas where innovators are still in the nascent growth stage with prototypes and some multi-industry pilots dominating the landscape.

A significant factor that will determine the course here will be how regulators and governments view the FinTech sector. Do they want to encourage and incentivise start-ups to challenge the incumbent financial players and nudge them towards greater innovation? Or do they want to ring-fence and protect the incumbent financial system from new potential risks or choose some sort of middle ground?

The disruption will last longer than anyone thinks
Disruption isn't a one-time event. It's not bound by the fiscal year. It's a continuous pressure to innovate that will shape customer behaviours, business models and the long-term structure of the financial services industry.

Any one of the innovation clusters has major implications, not just for incumbents and their customers but for the overall financial services ecosystem as well. Benefits of scale will erode. The universal banking model will become unbundled. New sources of capital will appear.

Together, they form a long-term trend from which incumbent institutions will emerge as aggressive, adaptable innovators, snapping up the best ideas of the start-up ecosystem and bringing them to fruition. The result will be a sea-change in the way financial services operate.

Southeast Asia highlights
With governments across Southeast Asia taking steps and initiatives to foster the innovation climate in financial services, it is expected that this wave of disruption will not be a one-off phenomenon. Singapore wants to cultivate a smart financial centre aligned to its Smart Nation aspiration, while countries like Thailand and Indonesia are providing encouragement in areas like payments and financial inclusion.

In summary, though there is a growing and strong view that the FinTech play is here to stay, we will need to wait and watch as to how this new wave in financial services develops in this region. This is especially true given every market in Southeast Asia has its own unique set of challenges and gaps that will need to be addressed by the financial services sector. This therefore necessitates continuous innovation across varied focus areas.

There's much more in the WEF study about how disruptive innovations are reshaping the way financial services are structured, provisioned and consumed. You won't learn where to place your bets, necessarily. But you might learn where to start your due diligence.

For full versions of our point-of-view, please visit *www.deloitte.com/future-of-fsi.*

Digital banking for small and medium-sized enterprises
Improving access to finance for the underserved

The following is an extract from a Deloitte Southeast Asia point-of-view report, which focuses on small and medium-sized enterprises (SMEs) across the economies of selected member states in the Association of Southeast Asian Nations (ASEAN) and the financing, banking and payment issues they face.

> "With the digital revolution, new business models are able to overcome factors limiting SME lending and address SMEs' varied financial and non-financial needs. Incumbent banks in the region have to think about what innovative business models works best and which partners will help them achieve the right solutions to cater to this unserved and underserved market."

Mohit Mehrotra, Southeast Asia Strategy Consulting Leader

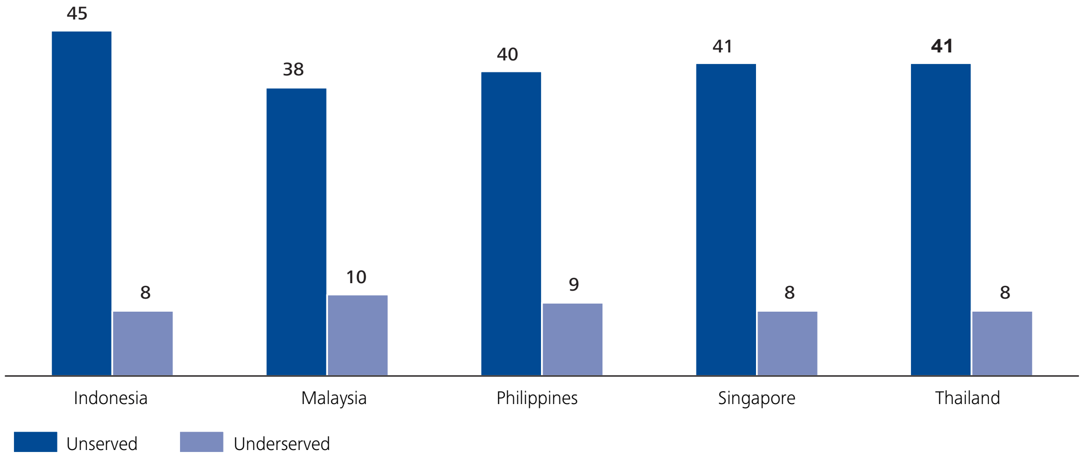
Small and medium-sized enterprises (SMEs) are an important segment in the economies of member states in the Association of Southeast Asian Nations (ASEAN). Across the five countries of Indonesia, Malaysia, Philippines, Singapore and Thailand, SMEs contribute between 30% and 60% of the countries' gross domestic product (GDP) and employ between 60% and 90% of the workforce.

These SMEs are fairly resilient to economic shocks and business cycles. In terms of geographical dispersion, 13% to 22% of SMEs are concentrated in the respective capital cities, while the remaining SMEs are fragmented across the rest of the countries.

Despite characteristic differences in the nature, size and composition of SMEs in the five countries, they share common financial needs such as better cash flow management, access to external financing and a more efficient payments system; as well as non-financial needs such as input costs mitigation, access to cheap quality labour, and a business-friendly climate.

Even though SMEs play a significant role in the economy, most have limited access to financing. Less than 60% of SMEs in the five countries have access to bank loans and approximately 50% of the SMEs are unserved or underserved by financial institutions.

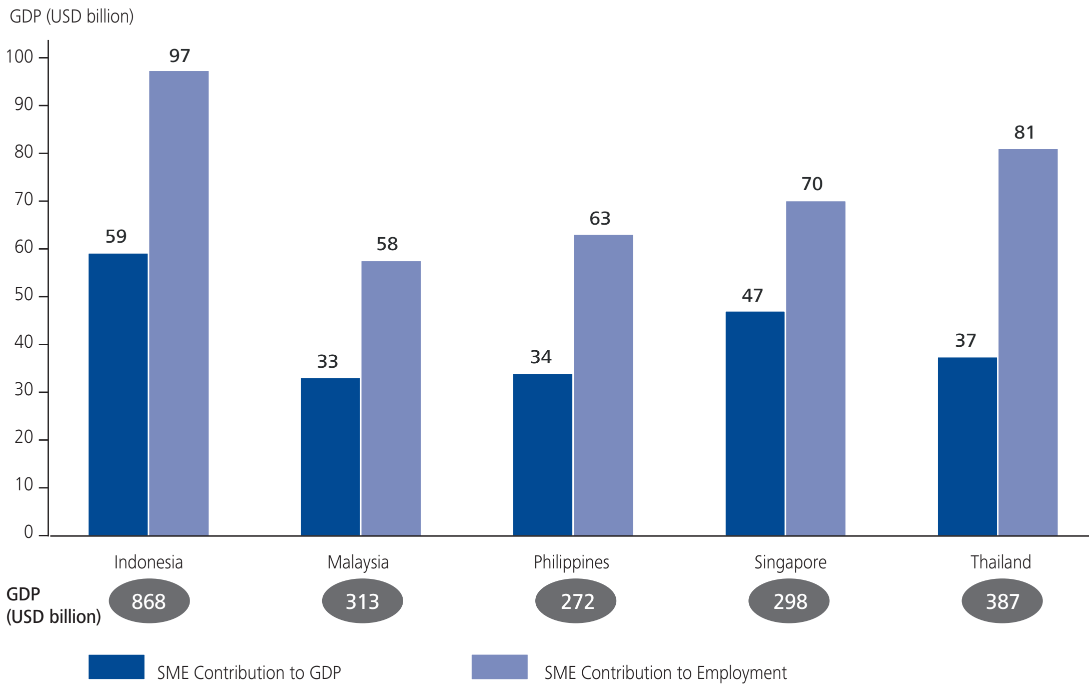
SME Access to Finance (%)



Note: [1] Report published in 2011 with Indonesia data from 2008, Malaysia data from 2009, Philippines data from 2009, Thailand data from 2006 and Singapore data from 2007. Unserved refer to SMEs who do not have a loan or overdraft but require a loan; Underserved refer to SMEs who have a loan or overdraft but face financing constraints

Source: International Finance Corporation Enterprise Finance Gap Database

The SME Contribution to GDP and Employment (%)

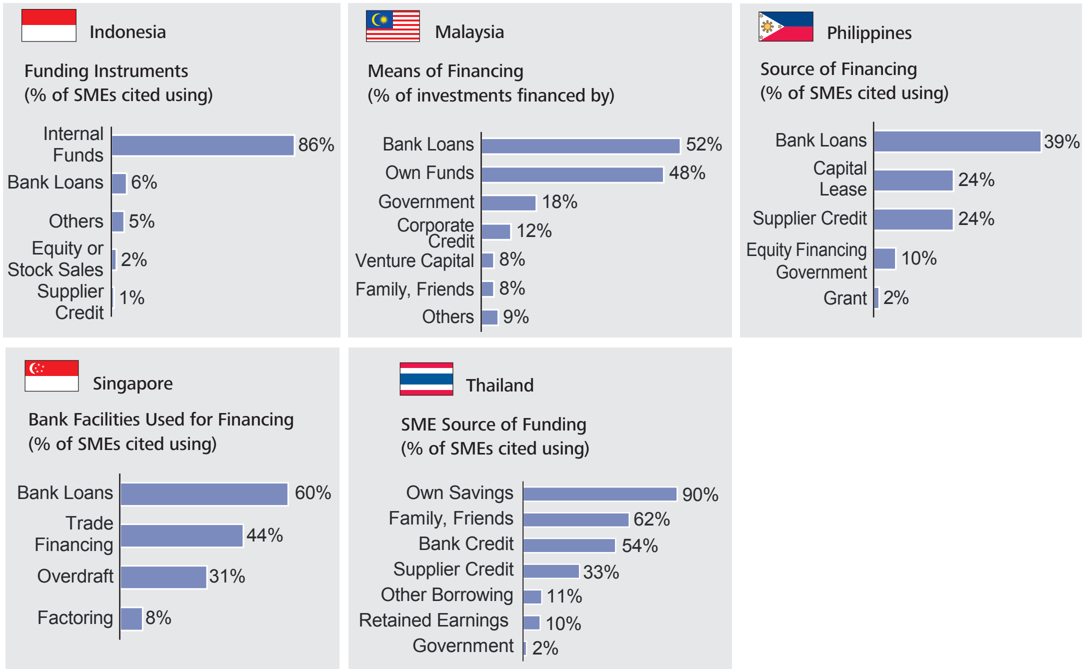


Note: Data from 2013 except for Indonesia (2012)

Source: Asia SME Finance Monitor 2013; SME Corporation Malaysia; Department of Statistics Malaysia; Indonesia Ministry of Cooperatives and SMEs; Thailand Office of SME Promotion SME White Paper 2014; APEC Policy Support Unit; Singapore Department of Statistics; DP Information Group

Figures also show that most SMEs in the ASEAN region still rely solely on their owners' private funds and savings.

SME Sources of Funding



With the exception of Thailand, SME loan volumes in the region are less than 60% of their contribution to GDP, and constitute less than 20% of total loans. This presents a sizeable opportunity for banks to target and increase lending to the SME market.

However, several key factors impede SME lending and result in poor financial inclusion of SMEs:

- The existing fnancial infrastructure, such as low SME coverage by credit bureaus/registries, increases the cost of SME credit risk assessment;
- Inadequate distribution channels limit banks from reaching out and servicing SMEs in either the physical or digital space;
- The lack of cash-flow visibility forces banks to adopt stringent collateral-based credit risk models which hinder lending to SMEs without collateral; and
- Regulations dictate that higher risk weights be allocated for SME loans and this raises the cost of lending.

These impediments are not unique to ASEAN but also prevalent in more advanced economies where SMEs have easier access to loans. In those countries, we see incumbent banks, challenger banks, financial technologies (FinTechs) and e-commerce providers seeking to fill the SME financing gap by adopting innovative business solutions.

These new business models are able to overcome the aforementioned key factors limiting SME lending and address the varied financial and non-financial needs by financing SMEs through alternative channels; using payments data to supplement credit risk models; capitalising on digital infrastructure to extend outreach; and offering a comprehensive suite of products and services.

With the advent of the digital age, financial institutions in the ASEAN region have to rethink the role banks want to play in the SME banking space to address the financing gap and capitalise on the SME banking opportunity.

Innovative solutions and business models to address SMEs' needs

	Finances SMEs through Alternative Channels	Assesses Credit Worthiness Using Payments Data	Extends SME Outreach using Online Banking Technology	Meets SME NFN through Innovative Products and Integrated Services
Incumbents				
Santander / Funding Circle	●			●
Int. SanPaolo / UniCredit / TMall				●
Challengers				
Aldermore			●	●
IdeaBank			●	●
Holvi			●	●
FinTech / E-commerce				
Alibaba Group	●	●	●	●
Amazon	●	●	●	●
Kabbage	●	●	●	

Improves SME Loan Volumes

Increases SME Customer Base

Creates Stickiness with SMEs

Financial institutions have options to organically build capabilities by leveraging digital solution providers or import capabilities by forming strategic partnerships with challenger banks, FinTechs and e-commerce providers.

Given the importance of SMEs to ASEAN's national economies through their significant contribution to employment and GDP, a strong well financed "banked" SME base which is able to expand regionally and internationally will support broader national economic stability and growth.

In order to achieve this, governments, policy-makers and regulators need to work in tandem to encourage an innovation-friendly business climate which encourages collaboration. If captured effectively and responsibly, the benefits to banks, SMEs, national economy and society will be immense.

For the full report, please visit our Financial Services Industry pages at www2.deloitte.com/sg.

“The increasing volume and complexity of the regulatory change pipeline, coupled with existing compliance requirements, will remain at elevated levels across financial services industry for the foreseeable future. In response, existing approaches to regulatory change management will need to evolve to productively address the pipeline.”

Thio Tse Gan, SEA Leader, Deloitte Asia Pacific Centre for Regulatory Strategy

Regulatory reform: The Asia Pacific state of play

The following is an extract from the Deloitte Asia Pacific Centre for Regulatory Strategy (ACRS) report on the key elements of the current international reform agenda and the application of these in the Asia Pacific region.

In the seven years since the onset of the financial crisis, regulation has emerged as a major strategic consideration for financial services firms. The reform agenda has fundamentally recast market structural parameters, such as those for banking services and over-the-counter (OTC) derivatives, and extended the regulatory perimeter to activities such as credit ratings and benchmarks.

While many reforms have been completed, our review of the current regulatory agenda indicates that it will remain full in coming years, particularly as existing standards are recalibrated or new topics of attention arise. We see multiple regulatory initiatives that represent the ongoing development and implementation of key post-crisis reforms, recalibrations of existing standards (notably the revisions to certain Basel standards, which are increasingly termed 'Basel IV') or the emergence of new areas of intense international regulatory focus (particularly on conduct).

We do not see diminution in this activity for the foreseeable future. Below are some highlights of key elements of the current international reform agenda and its application in the Asia Pacific region. These elements are organised around the major work-streams of the Financial Stability Board (FSB), of which we have highlighted a few:

1. Ending too-big-to-fail

   Supplementing the initiatives on making financial institutions more resilient has been the work on ending too-big-to-fail. This work has centred on identifying systemically important financial institutions (SIFIs) and introducing measures targeted at these institutions with the goal of ensuring any financial institution can fail without creating a systemic impact or recourse to taxpayer funds. Underpinning this work is the FSB's SIFI framework[2].

   While Asia Pacific jurisdictions, as with all reforms, are expected to implement agreed international standards, the appropriateness of the ending too-big-to-fail proposals to this region has seen concerns arise around the extent of global reforms. For example, it is likely that the final TLAC standards will contain an extended implementation timeline for Chinese banks and the ability to use pre-funded national resolution schemes, such as established in Japan. Such inclusions allow jurisdictions to remain compliant with the global agreements, while providing for different implementation.

[2] *Financial Stability Board Reducing the Moral Hazard Posed by Systemically Important Financial Institutions (November 2010).*

2. Over-the-counter (OTC) derivatives

While many jurisdictions, including those in the Asia Pacific region, have implemented or are in the process of implementing the reporting requirements for OTC derivatives, there is patchy implementation at best on mandatory central clearing and platform/exchange trading.

The following table demonstrates that while jurisdictions in Asia Pacific continue to implement policies in line with G20 commitments, varying timelines will see full implementation extend beyond 2016.[3]

Australia	Hong Kong	Japan	Singapore
• Reporting requirements will be fully implemented in Q4 2015. • Clearing obligation on major interest rate swaps currently in development (expected to come into effect in the first half of 2016). • Consultation on margin requirements for non-cleared transactions expected in the first half 2016. • Australia will issue its next assessment of trading appropriateness in Q4 2015.	• Trade reporting – framework is in place but full reporting not scheduled to start until the second half of 2016. • Consultation on clearing expected for Q3 2015 with a clearing requirement to commence in the second half of 2016. • Consultation on margin requirements for non-cleared transactions expected in Q3 2015. • Further study will occur in 2016 on mandatory trading.	• Reporting is fully implemented. • The clearing obligation will be expanded to capture further entities in the first half of 2016. • Intent to adopt margin rules in accordance with international timetable. • Mandatory trading of a subset of Yen-denominated interest rate swaps will commence in Q3 2015.	• Reporting of FX trades started in Q2 2015, with other asset classes reporting in the first half of 2016. • Clearing requirement expected to commence in Q4 2015. • Consultation on margin requirements for non-cleared transactions expected in Q3 2015. • Legislation for mandatory trading may be effective in second half of 2016.

3. Transforming shadow banking into resilient market-based financing

Shadow banking refers to credit intermediation that occurs outside the regulated banking sector. As Basel III has increased the cost of banking activity, there is the fear among regulators that risky activities could migrate to less regulated parts of the market (e.g. the capital markets, asset managers, new non-bank entrants).

Led by the FSB, a range of work has sought to identify and mitigate any risks with shadow banking[4]. Through 2015 and beyond, much of the focus is now on assessing the implementation of existing reforms, for example concerning money market funds and other shadow banking activities, and data collection to understand the sector.

[3] *See this report for an overview of the current state of implementation of the G20 reforms: Financial Stability Board OTC Derivatives Market Reforms Ninth Progress Report on Implementation (24 July 2015); available at: http://www.financialstabilityboard.org/wp-content/uploads OTC-Derivatives-Ninth-July-2015-ProgressReport.pdf*

[4] *Financial Stability Board Transforming Shadow Banking into Resilient Market-based Financing An Overview of Progress and a Roadmap for 2015 (14 November 2014); available at: http://www.financialstabilityboard.org/wp-content/uploads/Progress ReportonTransforming-Shadow-Banking-into-Resilient-Market-BasedFinancing.pdf*

4. Conduct and wholesale markets

2015 has seen the emergence of conduct as a key issue on the FSB's agenda. The FSB perceives that poor conduct in the financial system could reach a level that it poses a threat to systemic stability.

To date, the FSB has focused much of its attention concerning conduct on interest rate and foreign exchange benchmarks. This work, started in 2014, has seen and will see changes to the major FX[5] and interest rate benchmarks[6], including the shift from existing inter-bank offer rates to more transaction-based rates and risk-free rates (to completed by 2016[7]).

Looking ahead, the key international policy work-streams on conduct are those that have been recommended by the United Kingdom's Fair and Effective Markets Review (FEMR[8]). These will see the Bank for International Settlements prepare a code of conduct for the spot foreign exchange markets and International Organization of Securities Commissions (IOSCO) development standards for the fixed income, currency and commodity (FICC) markets more broadly.[9]

Within the UK, the key impact of FEMR is the recommended extension of the senior managers and certification regime to a broader group of FICC market participants. While the UK is seen to be leading this work internationally, the intentions of Asia Pacific regulators are aligned with these efforts. Fines have already been levied and actions taken in the region. Indications are that policy actions will likely follow the same direction.

Conclusion

There is still substantial international reform in play that will impact business strategy, and with no sign of slowing down, regulators and organisations in Asia Pacific have a complicated task ahead of them. Each framework brings a unique set of challenges, especially for organisations that operate across multiple jurisdictions.

Organisations need to monitor global and local developments as they look to design and invest in their business strategy, as managing the combination of regulatory reforms will be particularly challenging. However, firms that effectively integrate the regulatory outlook into their strategic thinking can achieve a strategy that is fit for purpose, now and in the future.

For the full report, please visit our Financial Services Industry pages at www2.deloitte.com/fsi.

[5] *Financial Stability Board Foreign Exchange Benchmarks Final Report (30 September 2014); available at: http://www.financialstabilityboard.org/wp-content/uploads/r_140930.pdf*

[6] *Financial Stability Board Reforming Major Interest Rate Benchmarks (22 July 2014); available at: http://www.financialstabilityboard.org/wp-content/uploads/r_140722.pdf.*

[7] *Financial Stability Board Progress in Reforming Major Interest Rate Benchmarks Interim report on implementation of July 2014 FSB recommendations (9 July 2015); available at: http://www.financialstabilityboard.org/wp-content/uploads/OSSG-interest-ratebenchmarks-progress-report-July-2015.pdf.*

[8] *Bank of England Fair and Effective Markets Review Final Report (June 2015); available at: http://www.bankofengland.co.uk/markets/Documents/femrjun15.pdf.*

[9] *See Bank for International Settlements Foreign Exchange Working Group (Press Release 24 July 2015); available at: http://www.bis.org about/factmktc/fxwg.htm.*

Effective delivery of private banking risk and regulatory transformation in Asia

This article was contributed by Yacin Mahieddine and Simon Tong. Yacin is SEA Leader, FSI Consulting and Simon is a Director in the Consulting practice at Deloitte Southeast Asia.

"The establishment of a transformation office for risk and regulatory projects will provide private banks with the foundation and infrastructure to understand and manage the avalanche of regulatory and risk issues they face. Private banks will have to continue investing heavily into systems and training to ensure that they are able to do business in a profitable, but compliant way."

Yacin Mahieddine, SEA Leader, FSI Consulting

Private banks in Asia are increasingly burdened by risk and regulatory requirements, in fact more so than any other segments within banking. Regulations span numerous dimensions and serve various objectives including investor protection, financial crime prevention, capital adequacy management, taxation compliance, professional code of conduct and risk management.

Whilst some of these requirements are globally dictated, others are specific to Asian regulators. For example, in the area of financial crime, whilst most regulators have adopted Financial Action Task Force's (FATF) 40+9 recommendations, Hong Kong and Singapore have gone beyond and enhanced regulations to include other dimensions such as tax crime or client due diligence requirements specific to private banking.

The plethora of risk and regulatory requirements can be overwhelming for any Chief Risk Officer (CRO) or Chief Operations Officer (COO) and the cost of compliance is becoming a key driver of rising cost-to-income ratios for Asian-based private banks.

Asia presents a geographical challenge with the need to comply with requirements of each jurisdiction where a private bank has a booking centre. For most private banks that have two to six booking centres across Asia Pacific, this incrementally adds to the challenges of interpreting and implementing regulatory requirements. This is different to other geographies such as Europe where there are common directives and the challenge is to align stakeholders across booking centres towards a common interpretation of European directives – for example, the Financial Market Infrastructure Act (FINFRAG) – and prepare a group response for compliance.

For CROs and COOs operating in Asia, there are several key challenges and they will need to carefully manage the complexities and effort involved with implementing new regulations.

Key challenges

Managing complexities of new regulations

- Regulations can overlap across multiple jurisdictions but still retain specific requirements and nuances which CROs and COOs need to accommodate.
  - For example, whilst both Hong Kong and Singapore have regulatory requirements for investment suitability, Hong Kong has specific requirements on risk rating investment products.
- Changes brought about by regulatory requirements can be extensive and impact an organisation's entire operating model from front to back office.
  - For example, Foreign Account Tax Compliance Act (FATCA)/Automatic Exchange of Information (AEI)/Common Reporting Standards (CRS) impact the entire operating model for a private bank from relationship managers in the front office to corporate actions and tax operations in the back office.
- Different regulatory requirements can impact common processes, organisational functions, IT applications and data sources.
  - For example, FATCA and Know-Your-Customer (KYC)/Anti-Money Laundering (AML) regulations can both impact the client on-boarding process and frontline staff.

Managing the cost of compliance

- Balancing the need for tactical workarounds versus longer term strategic solutions.
  - Banks are under pressure to quickly deliver a workable solution to comply with regulatory requirements, but have they properly thought through whether the solution is strategically agile and aligned with the bank's target operating model?
- Managing scope creep as the needs of other initiatives is declared as regulatory requirements.
  - From experience we have seen stakeholders 'piggy back' on regulatory initiatives to automate functions that were previously done manually and improving system functionality which would otherwise have been disapproved through a business case process.

Institutionalising effective governance

- Institutionalising effective programme governance spanning across regulatory initiatives and having centralised coordination of implementation planning and execution in order to manage interdependencies and organisational impacts across multiple initiatives.
- Creating ownership by the business to deliver upon regulatory outcomes.

Consequences of ineffective regulatory change management

The inability to effectively manage regulatory changes can potentially result in increased cost of compliance and poor quality of compliance delivery and execution.

Increased cost of compliance due to:

- Poorly planned regulatory change programmes;
- Lack of strategic approach towards implementation; and
- Lack of coordination around deployment of changes to commonly impacted processes, organisation units and technology.

Risk of poor quality of compliance resulting from:

- Lack of visibility on how regulations will impact the organisation and understanding the organisation's readiness for change;
- Inadequate involvement from board and management;
- Responsibilities for implementation not clearly defined; and
- Insufficient change management as regulatory changes are not properly communicated and understood by impacted employees.

How can compliance departments cope?

There are several key success factors when planning an approach to implementing numerous and ongoing regulatory changes.

Harmonisation and optimisation of delivery

- Identify similarities across common market regulations and harmonise requirements (where possible) through a regional set of policies and procedures which fulfil regulatory requirements across markets. This will allow banks to standardise the approach for compliance across booking centres.
- Optimise delivery by ensuring implementation interdependencies across regulatory requirements are highlighted and accommodated as part of implementation planning.

Coordination and collaboration

- Identify commonly impacted stakeholder groups across business, operations, IT, risk & compliance, legal and tax. This will allow banks to quickly identify who will be most impacted by regulatory changes and design interventions to manage the degree of change.
- Where possible implement a single point of contact to capture and manage common requests directed at common stakeholders. For example, have a single point of contact to initiate, capture and route technology requests from operations/risk to IT.

Strategic agility versus short term delivery

- Evaluate strategic versus tactical options in order to determine an optimal solution for the organisation balancing cost, flexibility and ability to respond to regulations.
- Consider cost effective delivery options including transfer of tasks to lower cost delivery locations.

Global/regional alignment

- For global and regional programmes, ensure consistency and alignment of vision and common understanding of goals and expectations including clarity of roles and responsibilities across local versus regional versus global teams.
- Ensure global teams are able to provide a target end state view and a clear design of the solution to be implemented in order to fulfil compliance obligations.

The need for a Risk and Regulatory Transformation Office

A Risk and Regulatory Transformation Office reporting to the COO and CRO can help effectively govern and coordinate delivery of regulation and their impact on organisation, process, technology and Management Information Solutions (MIS). Establishing a risk and regulatory transformation office can serve to manage and govern the portfolio of regulatory projects under implementation and coordinate the impact across commonly affected stakeholders to minimise disruption to business as usual and maximise efficiency of delivery.

This would involve:

Managing programme management office and stakeholder engagement

- Improved coordination across the organisation and reduced complexity of implementation;
- Alignment of key stakeholders in order to drive buy in to changes;
- Visibility of programme status and progress; and
- On time and on budget delivery.

Coordinating change management and embedding cultural change

- Consolidated understanding of how affected stakeholders will be impacted by multiple regulations;
- Centralised planning of training, communications and stakeholder engagement activities; and
- Creating awareness and embedding attitudes and behaviours around ensuring compliance through cultural change.

Driving deployment planning and support activities

- Centralised coordination of deployment activities in order to effectively manage change;
- Stress testing and pre-deployment readiness checks to minimise disruption to business as usual; and
- Deployment command centre to act as a point of escalation and first line of defence for deployment issues.

Centrally capturing and coordinating fulfilment of technology requests and requirements across risk and regulatory initiatives

- Efficient coordination and delivery of technology requirements; and
- Evaluation of solution options aligned to project requirements in order to balance the need for timely delivery whilst managing cost and alignment to the organisation's target technology architecture.

Conclusion

In summary, changes to the Global and Asian regulatory environment coupled with high cost-to-income ratios are calls for COOs and CROs of Asian-based private banks to respond to regulatory changes in a structured and coordinated approach. The establishment of a transformation office for risk and regulatory projects provides the necessary foundation and infrastructure to execute and coordinate regulatory change in an efficient and effective manner.

Asia Pacific Economic Outlook, Q4 2015

Malaysia, the Philippines, Taiwan and Thailand

The latest edition of the Asia Pacific Economic Outlook provides a near-term outlook for Malaysia, the Philippines, Taiwan and Thailand. The unexpectedly severe weakness in the Chinese economy is taking a toll on these countries. Though Malaysia and the Philippines are expected to continue to grow despite this challenge, the state of the economy in Taiwan and Thailand will depend on other factors including the political situation. The following are excerpts from the full report.

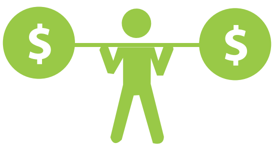
Malaysia

Under severe stress, but not frail yet.

Decades of strong growth has put Malaysia within sight of achieving the high-income status. In 2014, the economy enjoyed 6% annual growth. However lately, the economy has been experiencing strong headwinds. Economic growth lost momentum in Q2 2015 and grew 4.9% pre-deployment,[10] marking the slowest growth since 2013. The introduction of the goods and sales tax in April 2015 and low prices of liquefied natural gas, one of Malaysia's key exports, due to sluggish external demand were the primary reasons for slower growth.

Underlying weakness in economic fundamentals, too, contributed to the slowdown. Private consumption expenditure growth, which was at its lowest in four years, grew 6.4% in Q2, down from 8.9% growth in Q1. A weak labour market and high inflation resulted in lower private consumption expenditure, which was primarily driven by spending on food and beverages, transportation and communication in Q2.

Gross fixed capital investment growth fell sharply in Q2 from 7.9% in Q1 to 0.5%, marking a record low for the series. The fall was partly due to contraction in spending on machinery and new equipment. Public investment also contracted by 8% as projects in the oil and gas sector were either scaled back or cancelled due to falling oil prices. In general, high interest rates, low business confidence and poor economic reforms led to weaker private sector investment in the economy.



Philippines

Going good in turbulent times.

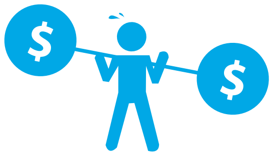
These are testing times for the world economy. Sluggish growth in the United States and Europe, a slowing China, uncertainty over monetary policy tightening in the United States and a sudden yuan devaluation in August have dented financial markets and currencies. In particular, GDP growth is likely to be a casualty for many emerging economies.

In such an uncertain environment, the Philippines appears to be doing well. The economy posted healthy growth in Q2, backed by solid domestic demand. With presidential elections slated for May 2016, public spending is also set to rise. Add to it solid external balances, low inflation and rising remittances, and the economy looks poised to ride out the current global uncertainty. There are, however, two points of caution. First, elections next year will likely bring policy uncertainty, thereby weighing on private investments. Second, slow growth in China will impact Filipino exports. Consequently, annual GDP growth for the Philippines is likely to fall short of the government's 7% target in 2015 and will instead end up in the 5.5% to 6.0% range.

In Q2, the economy expanded by 5.6% year-over-year, up from 5.0% in Q1. Among other factors, government spending on infrastructure and capital outlay went up by 37.3% in Q2.[11] Fixed investment growth slowed down a bit in Q2. However, at 8.9%, the figure is still a healthy one.

[10] Growth will be measured year-over-year in this article, unless specified otherwise.

[11] Official Gazette (Department of Budget and Management), "Infrastructure spending increases by 37.3 percent in second quarter," August 26, 2015; http://www.gov.ph/2015/08/26 infrastructure-spending-increases-in-2nd-quarter/.

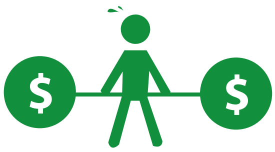


Taiwan

China's weakness takes a toll.

The unexpectedly severe weakness of the Chinese economy is taking a toll on Taiwan. In the second quarter, Taiwan's real GDP was down 2.0% from the first quarter, the sharpest quarterly decline since the fourth quarter of 2008 at the height of the global financial crisis.[12] This was due to an unusually sharp drop in exports. Moreover, the decline in exports clearly continued into the early part of the third quarter, with July exports down 11.9% from a year earlier and August exports to China and Hong Kong down 16.6%.[13] Taiwanese exports to China and Hong Kong account for about 40% of the country's total exports. Moreover, the weakness in exports had a spill over effect on business investment which has performed poorly. Thus, even if growth recovers in the third and fourth quarters, it is likely that full-year growth of the Taiwanese economy will be less than half the 3.8% growth clocked in 2014.

On the other hand, Taiwan's consumer sector continued to grow at a steady pace. A combination of lower oil prices, wages rising faster than the very low level of inflation and continued job growth have contributed to strength in domestic demand. However, as the impact of a weak Chinese economy continues, it could undermine the growth of employment and wages. Still, unemployment is very low right now, productivity is growing at a strong pace and prices are actually falling. Thus, a continued increase in real (inflation-adjusted) wages seems likely in the coming year. That, in turn, should be helpful in boosting consumer demand. Nevertheless, Taiwan has become increasingly dependent on exports in recent years. Thus, China's continued weakness will be a source of concern.



Thailand

A lacklustre recovery.

Thailand's economic recovery has been uninspiring. Economic growth continues to be reined in by weak private consumption and investment and the absence of growth in exports. Household debt remains perilously high, and the country's future political path is still uncertain. Consequently, consumer confidence has tumbled, declining for 8 consecutive months to a 15-month low in August 2015. On the external front, weak demand has stymied growth in exports. Further cause for concern stems from a slowing Chinese economy, the devaluation of the yuan and the impending interest rate hike by the U.S. Federal Reserve.

Thailand's weak economic performance over the first half of the year resulted in the Bank of Thailand (BOT) lowering its annual growth forecast for 2015. Factors promoting growth through the near term such as a recovery in tourism, low oil prices and an accommodative monetary policy are likely to be overshadowed by the downside risks to overall economic performance. It is therefore likely that the BOT will further lower its forecast for GDP growth in 2015.

Thailand's economy grew 2.9% year-over-year in the first half of 2015. However, the weak base for calculating year-over-year growth in 2015 (weak growth in 2014) misrepresents the actual state of the economy. Quarter-over-quarter figures reveal a more realistic picture. On a quarter-over-quarter seasonally adjusted basis, growth in Q1 slowed to just 0.3% from 1.1 in the previous quarter. Growth in Q2 was marginally better than in Q1 but still weak at just 0.4%.[14]

Read the full Asia Pacific Economic Outlook, Q4 2015 on www2.deloitte.com/fsi to learn more about short-term economic outlook for Malaysia, the Philippines, Taiwan and Thailand.

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[12] Oxford Economics, "Country economic forecast," Taiwan, August 2015.

[13] National Statistics, Republic of China (Taiwan), "Latest indicators," http://eng.stat.gov.tw/mp.asp?mp=5.

[14] Office of the National Economic and Social Development Board, "Gross Domestic Product : Q1/2015," May 18, 2015, http://eng.nesdb.go.th/Portals/0/eco_datas/account/qgdp/data1_15/BookQGDP1-2015-Eng.pdf; "Gross Domestic Product: Q2/2015," August 17, 2015, http://eng.nesdb.go.th/Portals/0/eco_datas/account/qgdp/data2_15/BookQGDP2-2015-Eng.pdf.

Contact us

Southeast Asia and Singapore Industry Leader
Ho Kok Yong
Partner
+65 6216 3260
kho@deloitte.com

Brunei
Pengiran Moksin
Partner
+673 222 2421
pmoksin@deloitte.com

Guam
Tung Wei-Li
Partner
+1 671 646 3884 x221
wtung@deloitte.com

Indonesia
Merliyana Syamsul
Partner
+62 21 2992 3100 ext 32590
msyamsul@deloitte.com

Malaysia
Anthony Tai
Executive Director
+60 3 7610 8853
yktai@deloitte.com

Philippines
Francis Albalate
Partner
+63 2 5819062
falbalate@deloitte.com

Thailand
Somkrit Krishnamra
Partner
+66 2676 5700 ext 11552
somkrishnamra@deloitte.com

Vietnam
Thinh Pham
Partner
+84 8 3910 0751 ext: 7180
thpham@deloitte.com

IFRS
Tay Boon Suan
Partner
+65 6216 3218
bstay@deloitte.com

Insurance
Raj Juta
Partner
+65 6800 2010
rjuta@deloitte.com

Risk & Regulatory
Giam Ei Leen
Partner
+65 6216 3296
eilgiam@deloitte.com

Audit & Advisory
Ho Kok Yong
Partner
+65 6216 3260
kho@deloitte.com

Consulting
Yacin Mahieddine
Executive Director
+65 6535 0220
ymahieddine@deloitte.com

Enterprise Risk Services
Somkrit Krishnamra
Partner
+66 2676 5700 ext 11552
somkrishnamra@deloitte.com

Financial Advisory
Suresh Marimuthu
Executive Director
+65 6216 3207
smarimuthu@deloitte.com

Tax
Michael Velten
Partner
+65 6531 5039
mvelten@deloitte.com

Outlook – Brightening, with opportunities of growth

In many ways, the financial services industry is on more solid footing than it has been for quite some time. The U.S. economy continues to improve, although concerns remain in both Europe and some emerging markets. Investor sentiment is a bit cautious, despite profitability being quite strong in many sectors.

But concerns — some new, some old — are keeping industry executives on their toes. Whether it's the evolving threat of cybercrime, the rising cost of regulatory compliance, or pressure coming from non-traditional competitors, financial services leaders have challenges aplenty. Agility, innovation, and collaboration will be important to capitalise on new opportunities for growth in 2016.

Are you ready to face the opportunities ahead?
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