

## Emerging Markets The new wave of opportunity



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# Foreword

There has been much news about the growth of the emerging market economies, and how institutions in the developed markets are looking to benefit from these fast-growing markets. But the untold story is the reverse; banks based in these markets have been gaining strength, and with that strength, are now looking to expand beyond their borders. Expansion within their home countries will take emerging markets-based banks only so far, and it provides little diversification when domestic economic volatility spikes downward. That's one reason why emerging markets-based banks are looking to expand into both developed and developing markets. Emerging markets-based banks are also following their customers, as they expand into new markets.

In this issue we explore the growth opportunities in emerging markets and other matters such as sustainable value for bank shareholders, private wealth management and challenges of the modern CRO.

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. The aim of Deloitte SEA's FSI practice is to help guide clients through challenging times and provide the insights that are required for success.

Please read on: we hope you will find this informative.

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# Banking across borders

## International expansion opportunities for emerging markets-based banks

As the global economy shifts, banks based in emerging markets are well-positioned for growth within their home markets and for expansion into new geographies. The banking systems in emerging markets were less impacted by the financial crisis and, as a result, their banks have stronger balance sheets, translating into capital which can be invested into growth opportunities.

### Trends influencing international bank expansion

#### World trade flows

We are seeing an increase in trade flows to emerging markets, much of it coming from Central and South America and Asia<sup>1</sup>. In particular, over the last several years, we have witnessed an increase in South-South trade (emerging market to emerging market). These trends in trade flows reflect and stimulate growth in these markets.

#### Growing GDP

According to the World Economic Outlook Database and the International Monetary Fund, emerging markets and developed markets each account for half of the world's gross domestic product (GDP) today<sup>2</sup>. Going forward, however, emerging markets will account for more than half of the global GDP and developed markets will account for less. Emerging markets pose a great opportunity for the future.

#### Fast-growing companies

Companies based in emerging markets are growing fast and gaining importance globally. When looking at the Fortune Global 500 list, which ranks the largest global institutions, the number of financial services firms on the list which are based in North America and Europe has declined, while the number of those based in Asia, Central and Latin America is on the rise.

Additionally, factors such as the growing middle class and new technologies have created an environment where banks, if positioned properly, can capitalize on domestic markets and demographics to achieve success.

The publication also delves into two case studies: Mitsubishi UFG and HSBC. Mitsubishi UFJ Financial Group (MUFG) is the largest banking group in Japan and the second largest bank in the world, based on assets, according to The Banker's Top 1000 World Banks ranking for 2013<sup>3</sup>. One of the key lessons that MUFG learned in the early years of international expansion was the importance of having executives work in major business and financial centers, such as London and New York. Such assignments allowed MUFG to demonstrate cultural respect to some of the organization's largest and most valued customers. Additionally, they also provided executives with high potential for advancement to gain firsthand exposure to the language and culture of the markets that the organization deemed critical to its future results.

Today, when MUFG bankers talk about their overseas success, they cite close ties to local information and culture through an operational structure built around local employees. Strong relationships with governments, information-gathering ability and know-how based on long-term commitment to overseas business are additional strengths<sup>4</sup>.



1 WTO International Trade Statistics, 2012, supplemented with Secretariat estimates prior to 2000. World Trade Report 2013, page 76.

2 World Economic Outlook Database, International Monetary Fund, October 2010.

3 "Top 1000 World Banks." The Banker July 2013: pages 114-130.

4 Mitsubishi UFJ Financial Group Global Strategy Presentation. June 2013. [http://www.muftg.jp/english/ir/presentation/backnumber/pdf/slides130619\\_e.pdf](http://www.muftg.jp/english/ir/presentation/backnumber/pdf/slides130619_e.pdf).

HSBC Holdings plc. (HSBC) is a multinational bank headquartered in London, United Kingdom. According to The Banker, it is the third largest bank in the world based on assets. The Bank operates in 85 countries, with a branch network of 7,200. The organization operates via four primary segments: retail banking and wealth management; commercial banking; global banking and markets; and global private banking. With the Bank's competency in financing local trade, HSBC was financing the export of silk and tea from China, cotton and jute from India, sugar from Philippines, rice and silk from Vietnam, and rubber and tin from Singapore within a decade.

They developed strong relationships with the local governments in these markets. HSBC's financial strength, exceptional client relationships, and regional focus in the Asian markets shielded it from the fallouts of the Great Depression. In the 1950s they began the withdrawal from China, leaving only one branch in Shanghai<sup>5</sup>. With these changes, the Bank decided to pursue an inorganic strategy and look westwards for growth. They acquired Chartered Mercantile Bank, headquartered in India in 1959. In the 1970s the management proposed a "three legged stool" strategy for expansion.<sup>6</sup> The first "leg" was Asia, which was already in place. The second "leg" was the U.S. with the acquisition of 51 percent of Marine Midland Bank in the U.S. in 1980s. In 1992, they purchased Midland Bank in the UK, completing its third "leg". These initial expansion efforts into key markets helped to build the Bank into the global player they are today.

Emerging markets-based banks can take the first step toward expansion into developed and developing markets by assessing their readiness along the following areas:

**Strategy:** Emerging markets-based banks need to understand the market segments they wish to pursue. They will also need to be focused, yet agile enough to adjust their strategies to assess and capitalize on unanticipated opportunities.

**Execution:** After defining a clear strategy for international expansion, emerging markets-based banks should focus on how they intend to implement their plans. In many developing countries, an alliance with an established local firm is almost a requirement for market entry; in others, foreign banks are allowed to establish representative offices, branches, and/or subsidiaries. Additionally, a number of governments provide support and incentives for their banks to expand internationally.

**Infrastructure:** Adequate technology and business systems is an essential ingredient for international expansion. Businesses need to address these limitations to ensure that customer records and transactions are supported by adequate capacity and protection.

<sup>5</sup> HSBC: Our Story. 2013. Page 20. <http://www.hsbc.com/about-hsbc/history/hsbc-s-history>.

<sup>6</sup> HSBC's History: <http://www.hsbc.com/about-hsbc/history/hsbc-s-history>.

**Talent:** The war for talent that many organizations face in their home markets is even fiercer abroad, where companies across industries — not just financial services — are vying for people who understand the culture, language, and business practices in emerging markets.

**Regulation:** Banks that expanded abroad three or four decades ago did not face the level of regulatory scrutiny that banks face today. Developing relationships with local regulators as well as a detailed knowledge of local regulations are important steps for emerging markets-based banks to take. Banks also need to understand the regulations they will face in their home country as a result of their expansion plans.

**Capital:** Although many emerging markets-based banks came out of the recent global economic crisis in fairly good shape, regulators everywhere expect domestic and foreign banks to meet heightened capital standards. Banks must be prepared to meet these standards for decades, not just years.

Emerging markets-based banks are uniquely positioned to prosper in developing countries. They already know how to reach the unbanked and under-banked segments in their own countries; this knowledge is an asset that can be translated into other countries and cultures. In addition, emerging markets-based banks have experience operating in often-volatile home markets. By taking stock of their capabilities, sharpening their strategic focus, and recognizing that international expansion is a journey, not a footrace, emerging markets-based banks can pave an effective path to future growth in other developing countries.

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# 2014 Private wealth outlook

## Championing growth



While worldwide wealth is growing, there is an increasing number of institutions competing for the assets of the relatively few, very wealthy families. The private wealth industry refers to the multitude of entities and institutions that serve the financial needs of high-net-worth individuals and families. Key players in this marketplace include private banks, private client groups, trust departments, and the wealth management arms of banks and broker-dealers. For this 2014 outlook, the focus is on a distinctive arm of the industry, the single-family office (FO), whose major defining characteristic is that all of its “clients” are members of the same family.

As the family evolves, the goals and dynamics of the FO can change quite dramatically in response. Balancing the diverse needs and desires of various family members, a challenge in any family, can be made significantly more challenging by the large amounts of wealth involved. Many large financial service institutions are devoting significant resources to serving ultra-high-net-worth families, intensifying the competition within the space. This will drive FOs to carefully evaluate when and how to partner with these institutions and when to go it alone. Some considerations for FOs are as below:

### Succession planning

It is an ongoing concern for many FOs, businesses whose fates are often tied to the founders, many of whom belong to the baby boomer generation and are now reaching retirement age. Like any family-owned business, an FO requires a succession plan that addresses the longer-term continuity of the enterprise. As more founders of FOs near retirement age, intergenerational issues, always a priority, are becoming even more important. Signs of a stirring economy are encouraging the less risk-averse families to explore new investment approaches. However, there seems to be a lot of money chasing a few good deals and the risks can compound quickly. FOs will likely continue to tread cautiously and carefully evaluate their investment options to see if the risk-reward ratio makes sense.

### Institutional approach to risk management

With the responsibility to prudently manage the family's wealth, governance has always had a preeminent position at FOs. As client interest grows in new product types and geographies, client reporting demands increase. Therefore, FOs are taking a more structured and formal approach to risk, compliance, and reporting, looking to regulated financial service institutions as a model. In general, FOs understand that they cannot mitigate every risk at once, and that a systematic approach to risk management can be very effective. This process usually involves several steps, including evaluating internal and external risk factors, prioritizing the highest risks, and remediating the highest priorities first. This emphasis on risk management involves significant investment, but most FOs believe that the investment is necessary to serve the needs of the family and protect both the family's wealth and reputation.

### Increasing demands on the finance function

The role of the chief financial officer (CFO) can vary widely at FOs based on the priorities of the family and the individual in the role. Some CFOs are more investment-oriented while others are more tax-centric, and still others may be more operationally focused. However, no matter what their focus, all of them bear significant responsibility in seeing that the wealth of the family is managed prudently and that family goals are being met. As the lives of wealthy families become more international, their investment choices broader and generational needs more diverse, the role of the CFO in FOs is evolving to meet new demands for transparency and reporting. Key aspects of the role include determining that due diligence will keep pace with investment options, and that reporting and disclosure of performance and fees meet the needs of the family.

## Technology

Technology adoption at FOs continues to grow with an emphasis on investment performance and tax reporting. However, while great advances have been made in recent years, there is still a strong desire for robust functionality to provide even more timely and accurate reporting. Concurrent with the increased adoption, technology risk has also risen and many FOs are investing substantial time to make sure that they carefully manage their technology risks. Technology remains in an evolutionary state at most FOs. Many are becoming more and more reliant on technology, which has helped tremendously in areas such as tax and client reporting. However, some FOs continue to face the challenge of supporting many independent systems. In some sense, as FOs catch up with larger institutions in technological capabilities, they are facing larger technological challenges. To respond to these challenges, FOs should consider adopting institutional-level programs around business continuity planning and, in particular, cyber security.

Many ultra high-net-worth families are broadening their investment portfolios in search of the right mix of risk and return for their portfolios. They are entering new geographies and participating in more direct investments. These investments, when combined with additional tax and client reporting demands, are placing a due diligence and operational burden on FOs. In response, some FOs are continuing to look to regulated wealth managers as a model and evolving to a more institutional structure that includes a renewed focus on procedures and controls. To implement these efforts, many FOs are seeking experienced wealth management talent and continuing to invest in technology. The increasing use of technology calls for robust business continuity planning and preparation for cyber attacks. Despite the competitive and cost pressures, the FO remains a structure with distinct advantages that is likely to remain very popular for wealthy families for the foreseeable future.

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## Six trends in the private wealth industry in 2014



Search for yield will continue, amid macro economic uncertainty



Focus on diversifying portfolio through new asset classes and geographies



Cost of compliance will continue to increase



Finance function will become more structured and organized



Focus on succession planning will gain prominence



Adoption of technology will increase as will the focus on cyber risks and business continuity

# Top 10 issues for banking M&A in 2014

Many large financial services institutions spent 2013 cleaning up balance sheets and getting back to core. Divestitures were the norm. Regionals mostly on the sidelines. Much of the year's activity was bottom up consolidation driven by smaller banks. Here's what banks should be thinking about this year.

Visit [www.deloitte.com/us/ma/bankingissues2014](http://www.deloitte.com/us/ma/bankingissues2014) to learn more.



**New regulatory paradigm** | The Volcker Rule, Basel III capital requirements, global liquidity rules, stress testing, Bank Secrecy Act compliance: they all matter. Banks should watch for compliance issues that could delay or scuttle a deal.



**Valuation** | Valuations during the financial crisis were so low that institutions could be purchased for their replacement cost value. Prices are rising, especially in the mid-market.



**Rising interest rate environment** | Rising interest rates could produce higher yield curves, making deposit liabilities more valuable. Banks flush with deposits and not enough loan demand may be especially attractive.



**Branch strategy** | The pendulum swings. Large banks may be selling branches as a way out of non-core markets. Smaller banks may buy them to gain local deposits.



**Search for capital-efficient growth** | In addition to acquisitions that expand a bank's loan origination platforms (e.g., auto financing and asset leasing companies), banks are searching for assets that can help widen margins.



**Tax** | Buyers and sellers should pay close attention to two major tax issues in the coming year: deferred tax assets and Foreign Account Tax Compliance Act implications.



**Underbanked market** | Some organizations are eyeing technology as a means to cost-efficiently serve the underbanked market. Private equity investors see this as a way to participate in lending and banking sectors without actually owning banks.



**Technology and data for business generation** | Companies needing technology and data upgrades may turn to M&A as an alternative to in-house development. Through M&A, they can acquire the capabilities to bolster data management and deliver more accurate, consistent, timely, and secure information.



**Geographic and business line rationalization** | Using M&A to fill strategic gaps in customer, product, and geographic portfolios is one way banks are repositioning for growth. Divestitures may be likely as multinationals and super-regional banks rebalance, prune branches, jettison higher-risk offerings, and right-size their workforces.



**M&A readiness** | Interest rates are rising, valuations have improved, capital reserves are robust, and the stock market is strong. M&A is heating up. Acquiring banks may need to be more flexible, nimble, and attentive to details, especially with transactions crossing multiple businesses, functions, and geographies.

# Arts, collectibles & wealth management

## Seeing the bigger picture

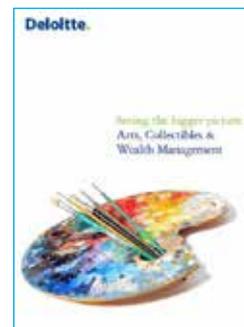
By Mohit Mehrotra, Executive Director, FSI Strategy & Operations Consulting

Asia, as the fastest growing market by number of High Net Worth Individuals (“HNWIs”) and total wealth, has been a key target market for wealth managers in recent years. However, intense competition, rising costs and a talent shortage in the wealth management space has led to market consolidation with the recent exits of Societe Generale, Bank of America and ING Groep from the wealth management business in Asia<sup>7</sup>. In order to survive and thrive in such market conditions, wealth managers need to either achieve economies of scale or specialize in a specific niche. While the majority of wealth managers are primarily focused on expansion of their footprint, digital transformation and profitability, this differentiation issue has still not been fully addressed.

In the current climate of economic uncertainty, the investment focus of HNWIs is shifting towards alternative investments, such as art and other collectibles. Besides emotional and social value unique to art and other collectibles, this asset class has shown low correlation with traditional asset classes, and hence is an ideal hedge against inflation and an important part of a HNWI’s portfolio diversification strategy.

Art and other collectibles have the potential to outperform equities over the long-term with The Economist Valuables Index of Art and Other Collectibles growing 64%<sup>8</sup> faster than the MSCI World index since 2003. Based on research conducted by Deloitte and ArtTactic, 83% of art collectors surveyed indicated the emotional value of buying art is the key motivation, followed next by the social value for 60% of respondents. Investment returns and inflation hedging were highlighted by art collectors as other important drivers to buying art and other collectibles with response rates of 40% and 25%<sup>9</sup> respectively.

Total investment in art and other collectibles (i.e. wine, classic cars, jewelry, gems and watches) reached USD 362bn in 2012 and is expected to grow at a CAGR of 10.3% and reach USD 621bn by 2017<sup>10</sup>. This expansion is largely driven by Asian markets, growing at a CAGR of 14-23%. As a result of such significant growth, markets like Singapore will reach a similar size as France (USD 16bn vs. 17bn) and China will exceed the total size of the UK and Switzerland (USD 102 vs. 83bn) by 2017. For 25% of Asia collectors, the main motivation for collecting investments of passion is capital growth<sup>11</sup>. This trend is evident in the new highs of Asian art prices in recent auctions. A porcelain cup of the Chenghua-era, nicknamed the “Chicken Cup”, was sold for USD 36ml in April 2014, setting a new auction record for a Chinese work of art. The previous record for a Chinese art piece was in 2013, when a bronze Buddha was sold for USD 30.3ml. Similar trends are seen for Southeast Asia art pieces with a new record of USD 7.5ml for a Southeast Asian piece of art — “Our soldiers led under Prince Diponegoro” painting by Indonesian artist, S.Sudjojono — 63% higher than the previous record set in November 2013 by the painting “Bali life” by Indonesian artist, Lee Man Fong<sup>12</sup>.



<sup>7</sup> “Private banking a tough sell in rising Asia”, The Straits Times (April 2014)

<sup>8</sup> “Fruits of Passion”, The Economist (August 2013)

<sup>9</sup> Deloitte Luxembourg & ArtTactic Art & Finance Report, 2013

<sup>10</sup> Wealthinsight Luxury Investments Report, 2013

<sup>11</sup> Knight Frank The Wealth Report, 2014

<sup>12</sup> “Chicken Cup sets China auction record with \$36 million”, Bloomberg (April 2014)

Despite the significant size of the art and other collectibles market and its rapid growth in the coming years, this market remains an uncontested space, given a lack of comprehensive services in this sector across Asia. The majority of wealth managers only focus on this space through brand sponsorships, valuation and advisory services. A Deloitte and ArtTactic survey on the key challenges of private banks in offering art-related services revealed that a majority (70%) of respondents are concerned by a lack of information and research on this market. Furthermore, 57% of private banks experienced difficulties in finding the right expertise in the art-related sector<sup>13</sup>.

Art and other collectibles wealth is a trillion dollar market and presents significant opportunities for Southeast Asia banks, especially in three key areas.

The first of these areas is simply the expansion into wealth management services for art and other collectibles investments; in doing so, the banks can cover both financial and non-financial assets of their customers to create a holistic view of their customers' wealth. As an example, one of the Ultra High Net Worth ("UHNW") clients of art advisory firm 1858 Ltd from an emerging market allocated approximately 6% of his total wealth, or over USD 120ml, to fine art.

Secondly, banks can use art and other collectibles wealth as an area to differentiate themselves from other players given the lack of established players in this space. Finally, new revenue streams can be generated to alleviate the high cost-income models that wealth managers in Asia are facing today (see Table 1).

Valuation and authentication are the most frequent requests from clients, given they are required whenever art and other collectibles investors buy, sell or insure a new piece of art. Depending on the determined value of asset and storage conditions, insurance premiums can vary from 0.3 – 1.0%<sup>14</sup>.



<sup>13</sup> Deloitte Luxembourg & ArtTactic Art & Finance Report, 2013

<sup>14</sup> "How art expenses stack up", Wall Street Journal (September, 2010)

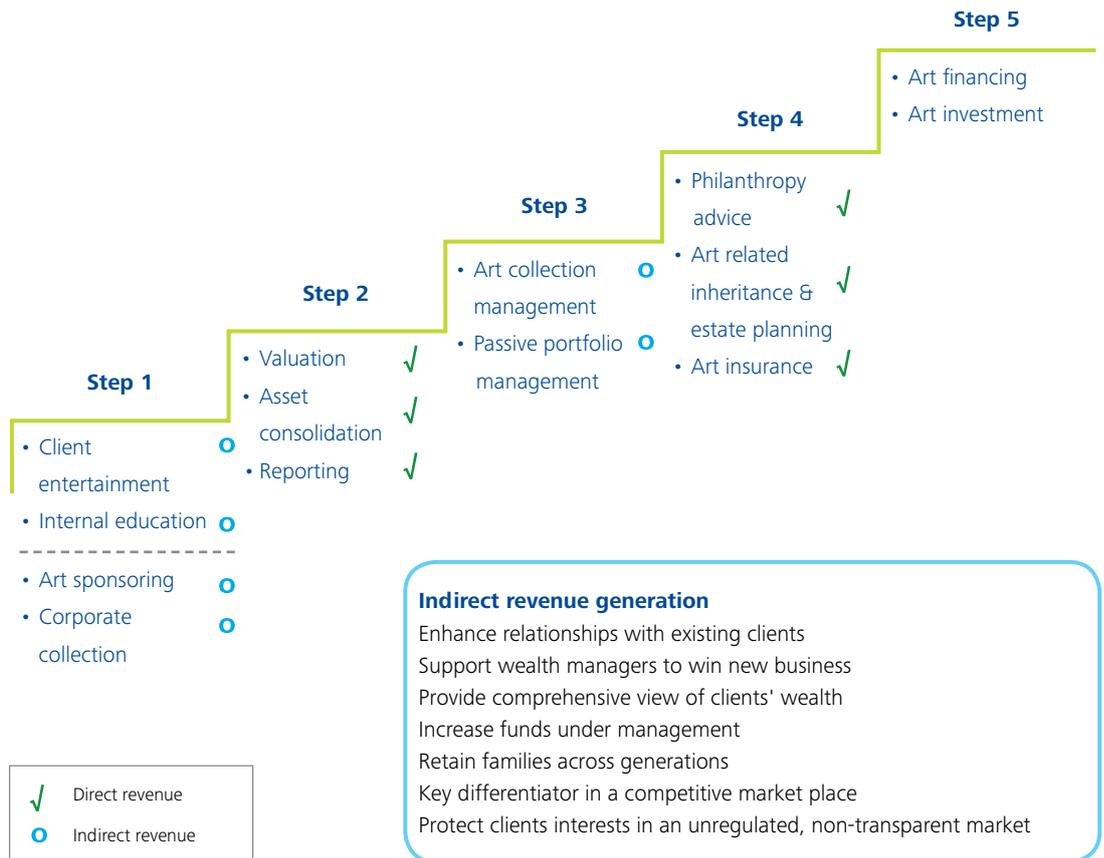
**Table 1: Revenue streams from art and other collectibles wealth management**

Indirect		Direct	
Service	Revenue	Service	Revenue
Client entertainment	<ul style="list-style-type: none"> <li>Enhance relationships with existing clients</li> <li>Support wealth managers to win new business</li> <li>Provide comprehensive view of clients' wealth</li> <li>Increase funds under management</li> <li>Retain families across generations</li> <li>Key differentiator in a competitive market place</li> <li>Protect clients' interests in unregulated, non-transparent market</li> </ul>	Buying and selling	Up to 10 percent of transaction
Internal education		Valuation	TBD
Art sponsoring		Consolidated reporting	TBD
Corporate collection		Reporting	TBD
		Authentication	TBD
Art collection management		Auction representation	Up to 10 percent of transaction
		Philanthropy advice	TBD
Passive portfolio management		Art-related inheritance and estate planning	TBD
		Art insurance	TBD
		Art financing	Spread: 2.5% Arrangement fee: 0.5-2%; LTV: 50%
		Art investment	TBD

Besides insurance coverage, there is also a growing demand from HNWI's to turn their art collection into liquid assets through art-secured lending. Art financing represents an untapped opportunity for banks to not only generate revenue, but also gain a greater share of HNWI's, given the limited number of banks involved in art financing in the region.

Creating a successful play in this segment requires a bank to cover the whole life cycle of art and other collectibles wealth via offerings from art education to financing. Deloitte's five step approach (see Figure 1) illustrates how a bank can develop a comprehensive art and other collectibles wealth management service offering. Starting from art education and sponsorship, a bank gradually expands their related services to the most complex and profitable ones: art financing and investment.

Figure 1: A step-by-step approach to develop your art/collectible wealth management service offering



Apart from the integration of art and other collectibles in the wealth management services, it is increasingly important to build up an ecosystem of partners that will accelerate play in this sector. Partnerships with art professional companies and other third parties will provide immediate access to existing expertise, a network of specialists and potential clients.

Deloitte launched its Art & Finance business advisory practice to specially serve this market. By working with not only the financial community, but also market professionals and cultural organizations, Deloitte Art & Finance have built strong expertise and a knowledge of the whole art market which allows the team to offer a unique and wide range of services for wealth managers from comprehensive strategic and operational support of art wealth management implementation to a specific analysis for offering art-secured lending services, research on selecting art and other collectibles funds, philanthropic planning and art digital strategy.

Art and other collectibles wealth management is an increasingly changing landscape providing unique business opportunities. Given the fast growing HNWI market, fueling double-digit growth of investments in art and other collectibles, and the art-related service offering gaps that exist in a wealth management space in Asia, this represents a significant opportunity for Southeast Asia's forward-thinking banks.

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# 2014 Alternative investment outlook

## Championing growth

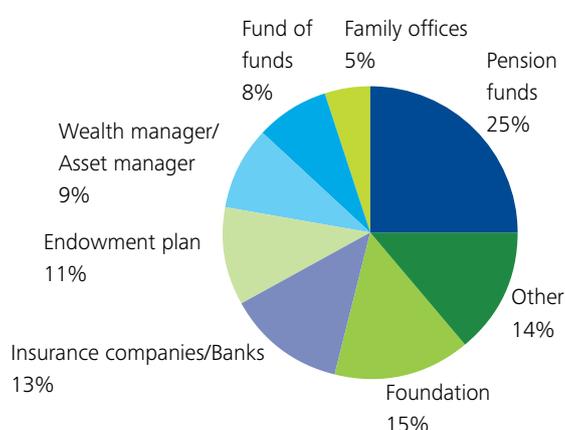
### 2014 Alternative investment priorities



#### Attracting new assets with scale and differentiating strategies

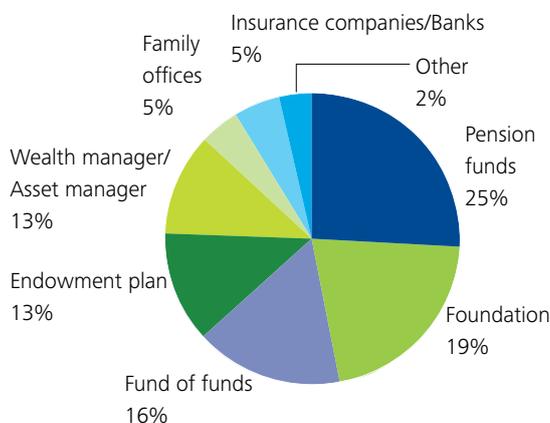
- Institutional investors are likely to allocate a higher percentage of their portfolio to alternative investments going forward
- Big funds will likely continue to get bigger, receiving the lion's share of institutional allocations
- Some institutional investors will look to diversify a portion of their holdings to emerging fund managers
- More alternative investment funds will likely go mainstream to pursue retail clients through 40 Act Funds and UCITS

#### Breakdown of private equity investors



Source: 2013 preqin investor network global alternatives report

#### Breakdown of hedge fund investors



Source: 2013 preqin investor network global alternatives report



#### Creating a competitive advantage through better data

- Alternative investment funds are looking to harmonize information into a single data platform to create greater transparency and customized client solutions
- More alternative investment funds will invest in a comprehensive data strategy that wraps in data warehousing and advanced data modeling
- Alternative investment funds will likely make room for a chief data officer to run the technology agenda

#### Poll Question

##### How is your firm currently handling the data challenges confronting the industry?

Proactively, we have a strategy and dedicated resources	29%
Currently evaluating a strategy and aligning resources	33%
Reactively, just trying to keep up with all the data requirements needed by investors and regulators	25%
No strategy in place	13%

Source: Deloitte Dbriefs, 2014 Investment Management Outlook, January 14, 2014



#### Managing external relationships and reputational risks

- Alternative investment managers will be more strategic about identifying and weighing risks when allocating resources
- More alternative investment funds are establishing service provider oversight frameworks to better manage their extended enterprise
- Alternative investment managers will take a more vigilant approach to cyber preparedness and establish an incident response team for cyber breaches

#### Poll Question

##### How is your firm currently handling the data challenges confronting the industry?

Insider threats coming within your organization	8%
External threats e.g. service partners, vendors	40%
Evolving technology	36%
Organized crime	16%

Source: Deloitte Dbriefs, 2014 Investment Management Outlook, January 14, 2014

# You think you don't need an IT strategy? Think again...

By Eric Pepper, Director and Dennis Trawnitschek, Senior Manager, Southeast Asia Consulting, Financial Services Industry

The role of IT is being challenged in the banking industry in recent times more than ever. Traditional IT in the financial services industry focused on core systems and cost efficient / always-on IT operations under the sole guidance of the CIO. However, today the use of technology is far more diverse and challenging and not under the guidance of only the CIO. IT has also become far less complex to deploy with readily available solutions in the cloud while demands of the bank's customers regarding technology have also changed drastically. Increasingly, it is becoming common for digital channels to be the main interaction point with customers anywhere at any time. Technology savvy customers do not just expect a multichannel banking experience but also an omni channel allowing them to do the same interactions in any channel. On top of this, both business expectations and regulatory requirements such as Basel III are requiring the banks to have strong data management and availability.

The reaction of many banks to these challenges is to separate the responsibilities and align the digital technology activities towards the Chief Marketing Officer. Alternatively, they are establishing a Chief Digital Officer role alongside the role of Chief Data Officer. This is often the result of IT being considered too slow and too rigid in handling new business requests to keep up with the new business developments, or in not having the required business domain knowledge.

This approach might seem like a feasible approach in the short term. However, in the longer term, there are significant associated risks. With an uncoordinated approach to technology, the overall complexity of IT will increase. While individual business cases might make it seem better to build solutions out of the box or in the cloud, operational costs are often forgotten. IT complexity is a silent killer of IT with increasing costs and higher risk of failure. This becomes particularly important when taking data requirements into consideration.

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But how do we find a solution to this problem? Deloitte recently conducted a CIO survey in Southeast Asia which highlighted that the number one challenge for financial services companies is understanding and aligning IT to the business. Only then will it be possible to fulfil the needs of the business and keep the risks and costs of technology in one space and allow the CIO to be the chief information officer.

Another challenge the survey has highlighted is the lack of the right skills in the IT department. While typically the businesses expectations are being met by the business as usual and maintenance aspects of IT, this does not apply to IT transformation and change projects. With upcoming technology trends - as shown in Deloitte's Tech Trends 2014 "The CIO as a venture capitalist" - this becomes even more important. IT is seen as slow to respond and not doing the right projects. The result is that the business is forced to work around its IT. A comprehensive and business aligned strategy can enable success by using technology to manage baseline costs as well as driving top line revenues. CIOs must take up this opportunity and work with the business to improve the value of IT and plan accordingly.

#### **So what are the key criteria for a successful IT Strategy?**

##### **1. *A clear understanding of what technology can do for the business***

Every IT strategy must start with the business and end with the business. What this means is that the starting point is understanding the expected outcomes and defining a path for achieving these expected outcomes. In order to be responsive, technologists in banks need to understand in detail the outcomes that the business wants to achieve.

But this goes even further; today technology can actually drive the business strategy. Digital enablement of customer interactions is on every bank's agenda. But this needs to fit into the existing core system landscape. Therefore, a CIO should take the opportunity to act as consultants to the business and push and pull information into the first phase of an IT strategy discussion. If they do this well with a business enablement mindset rather than thinking about constraints of the current environment this activity can allow the CIO to become a real C-suite member and sit at the table when business strategy is discussed.

##### **2. *An assessment of the current technology landscape on all sides of the border***

No technology strategy starts from scratch; there is always already some technology in place that needs to be incorporated into the solution. The important part in the assessment of technology for a holistic IT strategy is not to stop at the border of what is currently controlled by the IT department.

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**It is important to assess all the demands from the core business, compliance and risk functions in determining the total demand for technology in a bank.**

In today's banks, there are a number of technologies which are outside the direct control of the IT department. These include what is classified as non-core technologies: both cloud solutions, end-user computing (Excel and other tools) and outsourced technology. Besides these shadow IT technologies, there are also personal devices and web based applications. Only if all of this is assessed can there be a realistic understanding of the current state of technology. It is also important to understand that technology changes very quickly and traditional architecture approaches may not be able to keep up with the changing landscape.

Last, but not least, any constraints that cannot be changed in the current environment should be documented. This can be an intensive step in the process, but is important to ensure a comprehensive baseline.

3. ***An assessment of key trends, regulations and the competition***

Looking outside the box and assessing what is happening in the market is another key step in the process of developing a business aligned, future-proof IT strategy. This includes looking at technology trends and understanding whether or not they could support the bank's business.

It is important for banks to not just look at their traditional competition, but also at others like Google, PayPal or similar services, as well as the retail space. The new competitors, in particular, possess many technology aspects that can be leveraged to help a bank's IT department develop a better business solution, and therefore should be considered in their IT strategy.

Lastly, any technology related regulation like Basel III needs to be identified and considered.

4. ***Strategic themes define the priority***

Based on steps 1-3 outlined above, a bank must define its technology vision and the related strategic themes in order to ensure that the IT demand includes both the business strategy driven demand as well as an understanding of the competition.

The strategic themes will define the priority areas that the bank will focus on during the detailed target state development. These themes also build the connection between the detailed technology activities and the business strategy. They should consider all aspects of technology, whether related to core technology or new technologies.

5. ***The ability to think like an entrepreneur***

Traditionally, the target state was often driven by detailed architecture diagrams covering application, integration, data and infrastructure but the changing role of IT has made this approach too cumbersome and slow. The CIO now must think like an entrepreneur, building flexible and interchangeable solutions that can be dropped if they have not proven to be useful without major difficulties.

The target state should also focus on IT capabilities for both technical and non-technical people. Deloitte recommends that a Target Operating Model framework is leveraged; the IT vision and strategies identify the areas within the TOM that will need to change. Organizations should start by building the required IT capabilities, assessing their high-level sourcing model and understanding whether these are core or non-core solutions. This does not require detailed architecture activities but a high-level understanding of how these capabilities map into services and customers. This should be done with the current state in mind. Only for the core capabilities (core banking and direct related systems) can traditional architecture approaches be leveraged. For digital activities, only the interface needs to be defined, without the need for a full architecture. Each of these solutions can be handled modularly with the rules that apply to non-core capabilities.

The next key step is defining the people layer. This people layer is driven by the available resources and their skills. This does not mean that all required skills should be retained in the central IT organization. Skills can be embedded into the business, but this should be the result of careful consideration rather than inorganic and unplanned shadow IT growth.

While doing this, it is important to consider of the target state. This includes a realistic timeframe to think about the target state, bearing in mind that traditional IT strategies had a time horizon of 5 years.

#### 6. *To start with the business and end with the business*

As mentioned before, an IT strategy starts with understanding the business expectations and defining a path for achieving the expected outcomes. Defining a roadmap that delivers the business timeline is paramount to a successful alignment of business and IT. The initiatives required to transform the current state into the target state will need to be prioritized with these considerations in mind. In addition, regulatory timelines should be considered as well. Every year, the roadmap should be revisited and validated and adjustments made to reflect new requirements and constraints.

Technology is more important in financial services than ever. The growing diversity of technology is making it difficult for some CIOs. However, a comprehensive IT strategy enables overall higher returns on investment and better customer focus. Therefore, the importance of an effectively designed IT strategy is more critical than ever, and it needs to be developed by breaking away from traditional architecture driven approaches and aligned to the expected business outcomes. If this is done, the rewards for the bank could be significant.

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Deloitte's recent work has shown that a time horizon of more than three years is seldom valid, given the pace of change in technology. The target state also needs to be financially feasible, taking into consideration a high level understanding of the costs as well as available skills.

# See it first. See it through.

## Financial crime strategy roadshow



Financial crime is an ever-present threat for organizations and governments the world over. The value of what criminals take is only part of the cost—there are also penalties, civil judgments, and the cost of conducting investigations. Not to mention reputation. Corporate officers feel a perfect storm of pressure.

A siloed, minimal approach will no longer cut in. Corporations will need an enterprise-wide, integrated risk management strategy that takes into account its entire lifecycle: compliance, prevention, detection, investigation, remediation, monitoring, and testing.

Deloitte's Forensic Services practice recently conducted a series of financial crime strategy events in Hong Kong, Jakarta, and Singapore, bringing together senior decision makers within the risk, compliance and legal functions to discuss the barriers, drivers, risk and analytics factors involved in creating a holistic and effective financial crime strategy. Some of our key observations are presented below.

### Key Observations:

Executives clearly recognized the need to deal with financial crime holistically and identified the following issues with regard to their financial crime strategy formulation:

- The cost – both financial and reputational – of non-compliance is increasing
- A holistic change management process is an important factor for an effective financial crime strategy
- With ever increasing and more complex threats, financial crime benchmarking should be comprehensive and conducted regularly
- There are increasing regulatory requirements from local, regional and global stakeholders
- There is an increasing need for an analytical understanding of financial crime
- The complexity of implementation and on-going management of financial crime analysis and reporting is becoming a major issue for organizations
- Technology is key in highlighting potential areas of risk for organizations to be more focused or targeted in their efforts to combat financial crime
- Organizations' financial crime approaches are constantly changing and evolving to deal with new issues

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# The modern Chief Risk Officer

## Challenges and opportunities

By Frederic Bertholon-Lampiris, Director, Risk and Regulatory Advisory, Financial Services Industry

In a context of almost perpetual change for the financial industry, it is important to take a step back and identify the major global challenges and opportunities for the CRO going forward, as well as the top qualities that she/he must possess and demonstrate in order to succeed as a true value-enhancer to the organization.

### Strategic challenge: CRO influencer

The first challenge of the CRO – and the most important – is how his/her role is rooted into the governance and cultural scheme of the organization.

The strategic positioning of risk management in general, and the CRO in particular, is highly depending on the culture and history of an organization. Some still tend to consider it mostly as a compliance issue, a constraint and a cost. Others try and integrate the risk management function into their governance DNA and decision-making process. All agree on the fact that it is gaining momentum, whatever the starting point and all things being equal, moving towards a more strategic role in the organization.

From a regulatory perspective, some of the recent developments initiated by the national and international regulators tend to enhance the strategic dimension of the CRO and his/her role within top decision-making. In particular, requirements such as risk appetite statement, capital planning/ICAAP<sup>15</sup> and stress scenario programs put the CRO under the strategic spotlight, in direct relationship and higher interactivity with the Board. In that context, being an influencer has increasingly become a top quality for the CRO, in order to effectively communicate the key risks and vulnerabilities to senior management and to influence the way these are considered by the Board when taking strategic decisions in terms of business development.

### Tactical challenge: CRO partner

The second challenge of the CRO – is how his/her role and contributions are perceived by the various business units.

The tactical positioning of risk management as a function, and the CRO as an individual, is maybe the most delicate tasks offered to him/her. Even if the first strategic challenge is successfully overcome, it does not necessarily imply a systematic buy-in from the business. Even though 'tone from the top' is undeniably a good start, the CRO may still have to struggle in order to impose his/her views and find his/her place within the day-to-day management of the organization. In terms of strict leadership, being explicitly backed by the Board might even become a true stations of the cross, as the collaboration might be perceived by the business units as something obligatory, to be endured and thus not natural and sound. And that's where a fundamental difference exists between the CRO and internal audit function. For instance, the latter by its design has to maintain a strict distance to the business, whereas the former needs to develop a true advisor relationship. Ultimately, the CRO's goal is to create the basis for a strong, trust-based and sustainable partnership with revenue generating units, so to act as an efficient downside protector to the value generation function.



<sup>15</sup> Internal Capital Adequacy Assessment Process

### Technical challenge: CRO inquirer

The third challenge of the CRO – and maybe the most complex – is how she/he captures and manages the increasing complexity of her role.

The technical positioning of the risk management function is an increasing challenge for the CRO. Over the last decade, the overall risk management profile as a practice has changed dramatically, successively transitioning from a siloed aggregation of individuals (hermetic-heterogeneous, 'model a') to a more structured multi-disciplinary pool (collaborative-consolidated, 'model b'), and ultimately moving towards the emergence of a trans-disciplinary profiled team (interactive-integrated-innovative, 'model c').

The higher complexity of the role directly comes from the higher level of intricacy between today's key business drivers: the markets, the clients, the competitors and the regulators. Not only does the CRO need to understand each of these driver's potential sources of risk to the organization, but he/she also has to comprehend the corresponding connections and interactions and how this could translate in terms of potential vulnerabilities going forward. Besides this, it requires the ability to understand the business and products, to embrace technology revolution like social media and less conventional sources of information and, to integrate these into the risk sensing/discovery function. This faculty to develop a more forward-looking and anticipatory vision of the organization

constitutes a key vector for innovation and what is known as acting as an 'inquirer for the CRO'. This is also where the technical dimension circles back to the tactical and strategic ones, with the ability of the CRO to effectively translate complex risk information into appropriate terms/concepts and articulate them with concrete business implications for senior management. This "popularization" ability is maybe the noblest one for the CRO as it combines technical complexity with a strategic view, towards being able to make essential decisions for the organization.

Learning how to become and act as an influencer to the top decision-makers, a partner to the business-running and an inquirer towards risk-discovering – in one word: a leader – is not something that naturally triggers once one reaches a CRO position, but instead, has to be considered and nurtured from the start and along the career path of every risk manager. Beyond prerequisite qualities like integrity, respect and competency, the promotion of the "influencer-partner-inquirer" behavioral triptych for the CRO will also contribute to the progressive infusion of a better and stronger risk culture for the entire organization and ultimately for the industry as a whole. As Abraham Lincoln put it, "the philosophy of the schoolroom in one generation will be the philosophy of government in the next".

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# Sowing the seeds

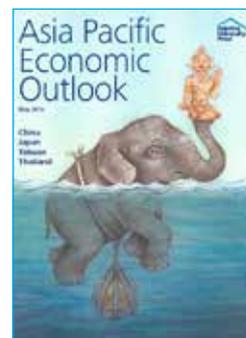
## Growth opportunities in emerging markets

### China

The economic slowdown in China continues, raising questions about the appropriate direction of government policy. In recent months, the government has indicated that it is more interested in addressing fundamental structural problems in the economy rather than focusing on growth. The economic slowdown has been brought about by weakness overseas as well as a tightening of credit market conditions by the Chinese authorities. It has said that it is content with growth in the neighborhood of 7.5 percent, which is quite slow compared with recent years<sup>16</sup>. And yet the continuing, and perhaps unexpected, deceleration in the economy has evidently caused concern. One serious criticism of the government is that it has allowed far too much investment, much of it wasted and much of it leading to excess capacity and, consequently, low or negative returns. The result is likely to be serious trouble for the financial industry, which has funded much of this investment.

The big question now is: to what extent the government will continue efforts to slow the growth of credit through the shadow banking system? Doing so will be critical in reducing the risk of bad debts. There has indeed been a slowdown in the growth of nonbank credit in the so-called shadow banking system. Yet, at the same time, there has been a commensurate boost to traditional bank lending. It appears that the government has encouraged banks to bring assets back onto their balance sheets. Despite the slowdown in shadow banking, there has been a rush into Internet-based money market funds that offer depositors a high rate of return with the ability to withdraw at any time. Formal bank deposits offer a return capped by the government. Such funds are not regulated, nor are the deposits insured.

As such, some analysts worry that they represent yet another risk to China's financial health. Interestingly, the Chinese government has approved trial plans for the establishment of five privately owned banks. These banks would compete with the large state-run banks and would be the start of larger plans to create a more market-based system of financial intermediation. The head of China's bank regulator said that "while private banks are subject to the same regulation as other banks, they should have also their own characteristics, especially focusing on serving small and medium-sized companies."<sup>17</sup> Interestingly, almost 90 percent of bank capital in China is now supplied by the government. One of the frequent complaints about China's banking system is that, due to the overwhelming dominance of state-run banks, smaller businesses have often been starved of capital. If China is to grow through innovation and entrepreneurship, then capital markets will have to operate on a more market-oriented basis and channel funds to start-ups and small businesses.



### Thailand

Thailand's economy has been hit by political unrest since November 2013. Snap elections in February 2014 to counter weeks of protests did not help due to a boycott by the opposition. In fact, the elections themselves were annulled by the Constitutional Court, thereby paving the way for fresh ones. With the current government continuing in a temporary role, the lack of clarity on key policies continues, especially those relating to rice subsidies and infrastructure. Stakeholders worry that even elections might not be able to solve this, given the widening rifts in Thailand's polity.

<sup>16</sup> Reuters, "Instant view: China aims for 7.5 percent economic growth in 2014," March 4, 2014, <http://www.reuters.com/article/2014/03/05/us-china-parliament-instantview-idUSBREA2404D20140305>.

<sup>17</sup> Sophie Song, "China banking reform: 10 private companies including Alibaba and Tencent allowed to set up private banks," International Business Times, March 11, 2014, <http://www.ibtimes.com/china-banking-reform-10-private-companies-including-alibaba-tencent-allowed-set-private-banks>.

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For businesses, both foreign and domestic, the current political turmoil in Thailand has clouded the investment climate. Even well-established businesses in the country have raised concerns. No surprise then that industry sentiment fell to its lowest level in 56 months in February 2014, reflecting businesses' concerns about the current political stalemate.

Even before the current unrest, households in Thailand were feeling the heat due to rising indebtedness. At 82 percent of GDP in 2013, household debt in Thailand is one of the highest in Asia. The current political instability has worsened the economic scenario. Consequently, consumer confidence fell for the 11th straight month in February 2014 to a 12-year low. This was despite income gains due to a tight labor market (unemployment is at 0.9 percent) and lower tax rates.

The Bank of Thailand (BOT) had cut its benchmark interest rate in March 2014 by 25 basis points (bps) to 2 percent, the lowest since January 2011. The BOT has been pursuing a loose monetary policy to prop up growth. However, it has admitted that growth is not

entirely possible without a stable political environment. In line with this view, it recently lowered its 2014 growth forecast to 2.7 percent from January's figure of about 3 percent. Growth is not the BOT's only worry; its monetary easing is also aimed at preventing household debt servicing costs from rising, something that would enhance risks for banks.

Until now the turmoil has not impacted Thailand's sovereign ratings, thanks to healthy public finances, improving external balances, and prudent monetary policy. However, a prolonged political conflict could change that, forcing investors and rating agencies to review their outlook. That could well be the biggest hit to Thailand's brand value since the Asian financial crisis.



## Financial Crime. See it first. See it through.

Financial crime is a constant threat across an organization's lifecycle, putting your money and reputation at risk in more ways than one.

Bribery, fraud and cybercrime are getting more sophisticated by the day, with regulatory agencies demanding increasing accountability. And as business embraces globalization, it encounters new and nuanced cultural and legal challenges. A purely reactive approach is no longer enough, let alone a fragmented one.

Deloitte has the vision, reach and capabilities to help you understand, anticipate, and mitigate these threats. And when crimes do occur, Deloitte has the tools to enable you to respond and recover from them as quickly and as painlessly as possible.

For more information on how Deloitte can partner with your organization to address this challenge in a holistic and effective way, visit the Deloitte Analytics pages on [www.deloitte.com](http://www.deloitte.com).