Managing change and risk in the age of digital transformation

The digital journey of financial institutions in ASEAN
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Digital transformation is gathering pace across ASEAN, disrupting value chains and transcending the traditional ways of conducting banking.

Digitalization is compelling financial institutions (FIs) to revisit their business models to engage and retain customers increasingly shaped by the digital world. Although digital transformation offers banks boundless possibilities for growth and value creation, it comes with its own set of challenges and risks.

This report unravels these challenges and risks through a series of client interviews conducted throughout ASEAN by IDC Financial Insights. The interviews uncovered new dimensions of digital risks, including: navigating fragmented ASEAN markets and regulations, interfacing with fintechs and managing risks brought on by changing from waterfall to agile development.

They also teased out two major challenges around:

1. **Customers:** Most FIs start their digital journey to drive internal productivity, focusing primarily on improving efficiencies and lowering cost. However, this fails to take into account increasingly sophisticated customer expectations of a rich, intuitive, hyper-personalized customer experience. FIs need to transform their front- and back-end systems to provide customers with ample choice and great value, delivered securely in an almost real-time environment.

2. **Regulation:** FIs must cope with different regulatory approaches concerning digitalization and Fintech across ASEAN. Some regulators lean towards protecting the status quo of their institutions; others demonstrate openness towards change and innovation. This makes compliance for regional FIs operating across multi-jurisdictions costly and challenging.

The answer to both of these issues may be for FIs to engage in a form of collaborative disruption with the fintechs to drive breakthrough innovation in the customer experience – while keeping risk and compliance in check.

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**Liew Nam Soon**
Managing Partner, Financial Services, ASEAN
Executive summary

For almost two decades, digital has driven incremental change in financial services throughout the ASEAN region. However, this process is reaching the limits of its ability to help FIs shorten time to market, lower cost and manage a growing compliance burden. At the same time, the rise of new technologies, new competitors and high customer expectations compounds the massive pressure on financial institutions to rethink the way they run their business. In response, industry leaders are embarking on a digital transformation journey.

The move towards transformational change requires FIs to rethink their established and successful traditional business models and explore new and fundamentally different ideas. This takes foresight, courage and determination. Primarily, digital transformation on this scale is not an issue of technology – but of culture. It requires FIs to overcome internal and external resistance, overturn operational traditions and remove technology legacies. The digital transformation journey involved is long and difficult – beset with many pitfalls and likely to involve numerous wrong turns.

This paper offers five critical themes for financial institutions to consider when developing their digital transformation strategy. On the basis of interviews with senior executives from banking, insurance, wealth and asset management institutions across ASEAN, it identifies the major roadblocks to, as well as challenges and risks of, digital transformation and examines how financial institutions are responding.
1 Staying connected and relevant to customers is a top challenge for FIs, given the speed at which customer’s needs, preferences and attitudes are changing. As other industries have raised the bar in customer experience, consumers have come to expect a relevant, personalized, interactive and immediate relationship with their bank, via a channel of their choice. The industry has to aim for a much deeper understanding of its customers leveraging transactional, social and other external data, and move beyond the basic segmentation widely used today.

2 Monetizing the digital business will challenge FIs as long as value propositions, sales channels and business models remain focused on the physical world. Monetization will require FIs to change existing products, distribution strategies, and marketing and sales capabilities to fit a digital environment.

3 Creating an operating environment that drives productivity, speed and innovation is critical to deliver the instant nature of a digital experience while keeping operational cost in check. FIs still locked into aging legacy technology, complex process architectures and a culture of incremental change, will struggle to be relevant to customers and monetize digital. Technology alone cannot break this impasse. FIs need cultural change to become an agile, automated organization.

4 Managing compliance in an era of rapid change is crucial. Despite regulators becoming increasingly open to the industry’s need to digitalize, we see considerable potential for closer collaboration and policy alignment. That said, the biggest barrier to digital transformation is unlikely to be the regulator, but the way compliance and risk is managed internally.

5 Dealing with the new dimension of digital risk is more important than ever given emerging threats, such as disintermediation, and intensifying existing threats, such as cybercrime, data loss, technology outages and third-party risks. The policies, frameworks, and technologies that have guarded the industry so far may not be sufficient to address these new and intensifying digital risk.
Digital transformation – a cultural challenge, not a technology issue
Digital transformation is much more than just a technology issue because it:

1. Describes the continuous process of adapting to changing customer needs by leveraging digital competencies — such as mobile, social, cloud, and big data — to innovate business models, products, and services.

2. Creates an efficient way to deliver a digital value proposition in an organization increasingly based on process automation and straight-through processing.

3. Depends on organizational culture to fuel the transformation with the right talent, incentives, and objectives as well as new approaches to generate ideas and develop new digital initiatives.

In other words, it requires a comprehensive change agenda permeating the entire organization. The starting point for a new digital initiative is no longer how to improve existing capabilities, products and services. Instead, it should start from the premise of how to increase value to customers.

1.1 Staying connected and relevant to customers

The traditional FI organizational structure was built along product lines and processes rather than following the customer relationship. As a result, FIs have inherited a large number of individual systems, data siloes, and data management issues — all of which make it challenging to automate, streamline and simplify processes to enable a consistent, enterprise-wide customer experience. Culturally, it also means that leaders tend to judge success on the basis of the benefits gained from adopting the product or process — not on whether the product or process is what’s best for the customer in the first place.

Both of these factors — technological and cultural — hamper an FI’s ability to match customer expectations of what a digital experience should look and feel like. They expect a customer experience that is intuitive, simple, relevant, secure and instantaneous — yet still personalized and offering both choice and value. These demands, which would have seemed far-fetched a decade ago, are already being delivered in other industries.
Addressing customer needs, not demographics:
FIs are sitting on a wealth of customer data, yet they often rely on rather basic segmentation criteria, based on customer’s value to the organization and demographics, such as age, gender, income and net worth. Using this data, FIs can identify profitable customer groups and start to build a strategy to target these segments. However, they can't generate insights into what the individual customer really needs and what is relevant at a particular point of time.

The point is, customers are not a homogenous group. Most of them do not directly communicate what they want and, even if they do, it will probably change by the time it can be productized.

FIs need to move beyond mere speculation about customer needs and towards truly understanding their requirements. This will mean asking different questions and looking at different sets of data that shine a light on customer behaviors, attitudes and perspectives – and how they change over time. To unlock the value of such data and leverage insights in real time, FIs need to build new data management and data analytics capabilities.

For example, a Singaporean bank leverages big data to understand customer needs and behaviors to deliver a better call experience in its contact center and drive operational efficiency. Based on 3.5 million transactional data points, the bank developed clusters of customer affinity, behavior and sentiment to increase cross-sell revenues, move customers to self-service channels and reduce the failure demand.¹

Leveraging outside-in design:
Inspired by other industries, design principles are changing fast in the financial services industry. Many banks and insurers are analyzing customer needs using outside-in methods, such as customer journey mapping, crowdsourcing, focus groups, and end-user testing. However, FIs should be aware that such methods are vulnerable to bias: the focus may gear toward certain customer segments or the interviewer may lead or misread the results.

Understanding the future of customer interaction:
Although a growing number of customers no longer want to come to a branch, a large part of the customer base in ASEAN still prefers face-to-face interaction with their FIs.² Whether physical or digital, the frequency of bank interactions across all channels is growing. Banks have been trying to transform the nature of branch transactions toward high-value services, such as advisory or sales, but they still struggle to embed the branch seamlessly in their overall distribution strategy.

To create an omni-channel experience, FIs must break down channel siloes, allowing customers to shift seamlessly between channels depending on their preferences and regulatory requirements. In this increasingly remote environment, mobile and data analytics will be the key enablers to improve and personalize the customer relationship. In the interim, while regulators and customers adapt to digital-only banking, branches will still play a crucial role for FIs.

¹ IDC Financial Insights Innovation Awards 2016
² “Winning through customer experience: EY Global Consumer Banking Survey 2014”

Any design should start with the customer and then work backwards to the product or service.

Steve Monaghan, AIA
### 1.2 Monetizing the digital business

To date, digital channels have largely retained a transactional nature and FIs have not redesigned their products to suit digital distribution. As a result, FIs are struggling to transform digital from a cost center to a revenue driver. In future, data will be the key to every customer engagement, making analytics critical to targeting customers with relevant products at the right place and at the right time. At the same time, FIs need to focus on creating customer journeys that specifically translate to revenue growth and a better customer experience. Innovation for its own sake will not do.

**Treating data as an asset:** Digitalization will give FIs access to one of the industry's biggest assets — a rapidly growing pool of transaction data. But, how this data can be used and shared is the obvious challenge no one wants to address. Data privacy will limit an FI's ability to use this data to cast a wider net in customer acquisition, or even to improve customer engagement, product development and distribution. Data commingling between organizations is an attractive proposition; however, there are many hurdles to be overcome.

With growing competition from inside and outside the industry, FIs need to get closer and become more relevant to their customers. The future battleground for sales will be in targeting customers as soon as they indicate interest on social media or are actually in the process of buying, on an e-commerce, real estate, automobile, or travel platform.

Partnerships may help FIs quickly gain the capabilities to join this battle, but disruption is not just a one-way street. FIs themselves could move out of their traditional domain. In Indonesia, for instance, a bank is moving into the e-commerce space, offering their merchant partners a platform with payment services.3

**Moving towards digital products**

Changing an existing business model is always difficult, especially one that has proved highly successful in the past. For example, in the insurance sector, reliance on the “agent model” – predicated on the idea that life insurance is sold, not bought – has long prevented the rise of online life insurance. This completely different sales model turns the industry on its head with simplified products, more choices – particularly in price versus scope – comparability, self-service financial management tools and contextualized offers. It was considered completely unfeasible until the recent surge of the China market, which grew by almost 350% in the first half of 2015 to take 3.5% of market share, proved otherwise.4

**Learning from other industries**

FIs can emulate the success of other sectors when improving digital engagement. Examples include: Amazon and Apple’s data analytics-driven approaches “people who bought this also like this”; budget airlines offering a basic product but giving customers the choice of paying for added value; and product bundling to incentivize positive behaviors, for instance, selling a car loan with car insurance, but reducing insurance rates for a disciplined loan repayment. New technologies are also a source of new business models, with connected devices enabling personalized, consumption-based business models. This year, an Australian life insurer is giving customers a preferred rate for living an active, healthy lifestyle, corroborated by a fitness band.5

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2. China’s Online Insurance Sales Near $1.38 USD In H1 2015, August 2015 at technodes.com/2015/08/20/china-online-insurance-h2015
4. Ng Yoh Thai, Great Eastern Life

The question is: what can I do outside the FI space? My take is: understand the principles, what the regulators want, do the right things by being customer-centric, and innovate to break away from the current mold in order to value-add. I believe Google’s and Amazon’s innovations are not reckless but operate with their customers in mind. The key is how one seizes the opportunities and has the resolve to make them happen by transforming the business.

Ng Yoh Thai, Great Eastern Life
1.3 Creating an operating environment that drives productivity, speed and innovativeness

One of the reasons for the slow pace of change in the financial services industry is that executives often view digital transformation too narrowly. Many digital initiatives introduce a digital capability at the front end, but do not touch back-end processes and technology. For example, a bank might make a mortgage application form available online, without addressing the paper-heavy, two-week process that sits behind it. The result is a cosmetic change without considerable impact on customer experience, staff productivity, turnaround times or cost.

Aspiring to more than cosmetic changes requires a comprehensive rejuvenation of operations, middle- and back-office systems, data assets, and staff capabilities to allow for a coherent front-to-back proposition.

- **Building a digital bank-in-a-bank:**
  Transitioning to a new model is complex, costly and time-consuming. Not surprisingly, some banks prefer to take a greenfield approach, such as a “digital bank-in-a-bank” – either as a standalone digital subsidiary or as an internal service provider to the “old” bank. Starting the design of a digital initiative from scratch, without the limitations of legacy operations and technology, allows greater innovation and supports cultural change. Launching and testing a digital platform in a new market also reduces the risk to the existing organization. Although a standalone digital-only platform may eliminate certain legacy issues, it faces similar challenges when it comes to availability of human resources, customer readiness and acquisition, and monetization. In the past, online-only banks have failed to succeed in Asia. It will be interesting to see if digital-only or mobile-only banks will fare better with customers.

- **Changing culture to support digital transformation:**
  Senior management support is essential for the success of digital transformation. Cultural change requires vision, the will to break with traditions and explore new ideas, and an openness to allow failure. This mindset is often rare in Asian FIs, where boards and management tend to be conservative and traditional.

  To really succeed, change must cut deep into an organization. Cultural transformation must empower staff to drive change and challenge the status quo with new ideas. A digital strategy needs to permeate the entire organization to break down organizational siloes and hierarchies to facilitate cross-departmental and external collaboration. It also has to revisit traditional performance metrics, and incentive and remuneration models.

  Looking at traditional key performance indicators (KPIs) and sales incentives, frontline staff are usually only rewarded for sales in the branch or during face-to-face interactions, as these can be attributed to an individual. As a result, people have little motivation to drive digital sales. Motivating staff to adopt the new, digital way of doing things requires incentives that support this change; for example, by rewarding customer satisfaction, team effort, and overall digital sales.
As FIs need fewer operational staff, role profiles are changing. New capabilities such as experience in emerging technologies, digital marketing, design, and other non-traditional fields are needed to drive new ideas. As head of a Malaysia-based regional private bank says: “Digital talent acquisition has become like a war in the industry. Even frontline staff needs to stay on top of the rapid change, for instance, when talking to a client’s kids, ‘social’ has become important.”

Traditionally, diversity and inclusiveness have not been the industry’s forte, but this will need to change. Training and capability building are essential to help the existing workforce adapt to future requirements. Moreover, managers will need intuition and tact to reduce potential friction between old and new staff, while keeping everyone motivated.

**Increasing speed to market with new methodologies:**

Speed is a critical success factor in the digital age — whether accelerating time to market for new products and designs, reducing process turnaround times, or increasing customer responsiveness.

When speed was merely an advantage and not a critical success factor, FIs relied on a structured and well-documented approach to software development, such as the “waterfall” methodology. In the waterfall model, discrete phases in a project — analysis, design, coding and testing — are completed sequentially. This linear approach has the advantage of creating projects that start with a clear idea of the end result, including project size, cost, and timelines. However, such projects also tend to be lengthy, prone to failure and inflexible. As testing and customer feedback are the final steps, projects run a risk of failing to address client needs. Also, to make changes, the entire process cycle has to be repeated, causing lengthy delays.

This is why waterfall development is being usurped by new approaches, such as agile design, that are fast and flexible. The agile design process is incremental and starts with a simplistic design idea. The project is split into small modules that run concurrently and are presented to users regularly for feedback. The module work happens in weekly or monthly sprints and, at the end of each sprint, project priorities are evaluated, tests are run and feedback is incorporated. This allows for continuous feedback from all parties — designers, developers, compliance, business units, technology vendors and customers — throughout the project. There is no pre-determined course of action. Instead designers respond to feedback as it arises and make changes as the project progresses.

Both methodologies have strengths and weaknesses, and should be applied selectively on the basis of the objectives and specific project requirements. With agile design, many moving parts are in play, making strong project management more important than ever. Clarity about the project’s value and goals are also crucial to avoid getting lost in multiple life-cycle iterations. The dramatic change in development methodology from waterfall to agile requires a change in organizational mindset and a new set of staff capabilities.

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Everyone should be driving innovation and digital. It is crucial to get the whole organization to go in the same direction and work together and not in siloes. We have aligned our KPIs and bonuses with this. The group-level scorecard was changed to drive our digital agenda. Innovation happens on multiple levels and has to be driven on all levels and projects, not just big experimental projects.

David Gledhill, Group Head Technology and Operations at DBS

Unless you are learning about all these new things... unless you take a fresh look at security... unless you explore different ways to design an application and scale up... unless you are really taking advantage of all of these things... you are not really adapting fast enough.

Steve Monaghan, AIA
One respondent sees agile design as most suitable to develop innovative front-end features, but cautions that organizations have to be clear where this approach is suitable and where it is not. In projects that have considerable interdependencies with core infrastructure, the risks of agile may outweigh its benefits.

**Breaking down data siloes:**

Traditional methods of collecting, storing and managing data prevent FIs from being able to respond quickly as market conditions and consumer preferences change. Many organizations continue to suffer from data siloes, poor data management and data governance programs, and incomplete or poorly executed consolidation exercises. Functional siloes tend to result in multiple versions of data, with data management tailored to the use of each function. A digital experience designed without a 360-degree view of the customer across channels, products, and interactions will likely fail.

Getting data delivered at the speed required by the business units is another challenge. For example, data feeds for front-office applications and payments often require data delivery that is near real-time, which is hard to achieve if the supporting data architecture has not yet matured.

**Using services hubs to overcome legacy constraints:**

Integration remains a key challenge for most organizations, due to different formats, disparate systems and, again, data siloes. Increasingly, FIs are investing in building integration layers in the middle office to accelerate the launch of new products and services, and support new front-end capabilities.

Particularly on the payments side, where change is happening quickly, service hubs built on service-oriented architectures are enabling FIs to quickly launch new services and channels without the need to touch their core systems. This removes much of the complexity and results in considerably shorter time frames to launch a new channel or product.

**Growing the innovation ecosystem:**

The Fintech industry has generated considerable hype – both in terms of potential disruption as well as potential partnerships. These lean and highly focused emerging technology players can move, adapt and change quickly – emerging as a source of innovation for the industry.

FIs have a wide spectrum of strategies at their disposal to drive innovation through fintechs. These range from “wait and see” doing nothing, “copying” their ideas, “partnering” to develop an idea together, “purchasing” a solution the traditional way or “acquiring” the whole start-up to bring the innovation in-house.

Those opting for M&A should be aware of the difference between dealing with an established vendor and a start-up.
Most banks are still finding their way in how to ‘react’ to the potential technological onslaught. It is great to see so many models being experimented with, be it labs, accelerator programs or beefing up internal capabilities. Whatever the building blocks are, banks must recognize that fintechs are just one source of inspiration. There are many others and an innovation framework must allow the bank to efficiently sieve through them, figure out which ones to put effort on and execute.

Amran Hassan, Head of Corporate Development & Innovation Group at Maybank
Dealing with emerging vendors requires FIs to rethink many aspects of the traditional FI-vendor relationship. These include: procurement, third-party risk management, regulatory reviews and audits for outsourcing services, data privacy and security, business continuity and integration with legacy systems. However, Ng Yoh Thai of GE believes: “The vendor ecosystem is changing, but I do not think this will be a massive, insurmountable problem. What’s crucial is that you have to be compliant in the build-up.”

The surge of Fintech – with many similar solutions – makes it difficult for FIs to identify good ideas and the right partners. Nonetheless, many FIs feel compelled to participate or at least “be seen” to participate in the Fintech hype. In recent years, we have seen a surge of well-publicized incubators, accelerators, and innovation hubs across Southeast Asia. Yet, at least for the moment, real innovation is missing. Before jumping on the Fintech bandwagon, FIs should consider the value of Fintech for the organization and put vendor risk management frameworks in place. The industry as a whole should also ask: How many more innovation hubs or accelerator programs does the sector really need? And what will be the incremental value of the next one?

Perhaps the most alarming development for FIs is the brain drain into the Fintech sector. Driven by the opportunity to found or join a start-up, many experienced bankers are leaving their jobs. Until the investment capital dries up for fintechs, FIs will miss the experience of these senior personnel to drive their digital transformation agendas.
1.4 Managing compliance in an era of rapid change

The relationship between regulation and digitalization is complex and sometimes ambiguous. Digitalization can improve regulatory control by increasing transparency and auditability, and reducing manual errors. On the other hand, regulators fear that digitalization may fail to protect customers and come at the expense of security, compliance and business continuity.

Understanding the compliance or digitalization issues:

In a heterogeneous region such as Southeast Asia, policies and regulations concerning digitalization and Fintech differ from market to market – and often even among the regulatory bodies within a country. Regulatory approaches contrast between preventing change and protecting the status quo, and demonstrating openness toward change and encouraging innovation. Some regulators take this a step further by proactively establishing ecosystems to foster innovation.

In emerging markets, regulators tend toward a rather passive and often careful digitalization approach. Although not actually preventing innovation, regulation is sometimes characterized by a lack of guidance and clarity on security issues, such as digital know-your-customer (KYC) protocols, or the use of technology enablers, such as cloud or mobile. Authorities sometimes fail to keep up with the rapid pace of technology evolution due to a lack of expertise, and limited interaction and consultation with other regulators, FIs and external parties such as technology vendors and independent experts.

Yet, in areas such as payments, remittances, and micro-lending, emerging market regulators have also led the way. Where banks have been slow to achieve policy goals regarding financial inclusion, regulators have allowed other industries to move into the financial services domain; for example, the development of mobile money in the Philippines.

Such examples aside, digitalization in emerging Asia is still in its early stages, with regulators often finding it difficult to move beyond proven rules.

Singapore stands out with its very active and supportive approach toward digitalization. In 2015, the Monetary Authority of Singapore (MAS) announced an initiative to create a Smart Financial Centre built on the back of a regulatory approach that supports innovation, while fostering safety and security. MAS also announced development initiatives to create a vibrant innovation ecosystem, including: support and funding for bank-led initiatives, such as innovation centers, and individual or industry-wide innovation projects; and a non-bank Fintech ecosystem to generate new ideas and provide a platform for collaboration. Although MAS has been very supportive of digital transformation, it highlighted the responsibility of FIs to safeguard innovation themselves by putting in place the proper due diligence and not looking to regulators for approval.

Regulators need to see things more from an innovation perspective. They need to engage the business to understand where we are going. For instance, while we want to move to digital, regulators insist on face-to-face interaction.

Head of private banking at an unspecified institution

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Moving internal compliance teams from gatekeepers to stakeholders of innovation:
Currently, legal, risk and compliance departments act as gatekeepers of, rather than partners in, the innovation process. These functions need to evolve to become consultants to the innovation process — analyzing the risks involved and providing solutions to ensure compliance and minimize other risks. This will require compliance staff to better understand IT, use new, dynamic models to assess operational risks and establish better controls to safeguard the process. It also means that the ultimate decision of whether to take a risk will now lie with the business — not the compliance team. This is a drastic change from today’s culture of control to a new collaborative culture of risk.

Solving the KYC roadblock to digital-only:
KYC protocols are hampering the move to “digital-only” for critical processes such as account opening, loan applications or investment advisory. Currently, FIs are continuing to rely on employee-assisted onboarding or some level of physical intervention to verify a customer’s identity. Proven solutions are available to automate this process, but their adoption remains limited. For example, electronic signatures, although accepted by most regulators, are not considered to be sufficiently user-friendly or convenient for the customer. Likewise, a few banks have trialed mobile data capture to verify the customer by taking a photo of the signature, an ID card or the customer themselves, but concerns about security outweigh the added convenience. After all, the signed original still has to be delivered by mail, which fundamentally reduces the benefits of a straight-through process.

Particularly in the wealth management sector, organizations have been working hard to standardize and facilitate a process that ensures product suitability and anti-money laundering compliance. Customers found the early trials inconvenient — to the degree of chasing them away. But now FIs are working on delivering a more efficient and appealing customer experience.

Tablet tools, such as those recently launched by a Singaporean bank, have come a long way in integrating the various systems used by relationship managers in a single interface — from customer relationship management, calendar and task manager, communication platforms to portfolio management, order management, proposal management and research. These tools deploy in-built workflows that guide the relationship manager through the sales process, ensure compliance and suitability, and complete the process with an electronic signature. This has greatly improved staff productivity as well as customer experience.

Ravi Menon, Managing Director of MAS

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Cross-border solicitation rules are a nightmare. How can we keep documents, offers, term sheets, research, and even transactions onshore, when our clients are global citizens?

Unnamed head of private banking at an ASEAN bank

Understanding the regulations governing cloud usage:
Cloud technology offers FIs an efficient, fast and inexpensive way to launch new digital capabilities. Although regulation governing the use of cloud is now in place across Southeast Asia, FIs keep blaming regulation as the main obstacle to using the technology. This indicates a misunderstanding of what the regulations really require.

Certainly, outsourcing and cloud regulations vary from market to market in degree and explicitness. FIs need to understand their market’s rulings on: data privacy abroad, security and business continuity requirements, and the obligation of FIs and regulators to review and audit services providers. However, no Southeast Asia market has a general ban on Cloud services, nor is there a requirement to physically segregate data. Some restrictions on the use of Cloud that FIs should be aware of include, China and South Korea mandating that data has to remain in-country include, Indonesia and the Philippines requiring regulatory approval for cloud outsourcing include, Malaysia requiring approval for offshore data storage include, and Thailand needing approval for material outsourcing.8

Waiting for regulators to simplify the cross-border challenge:
ASEAN’s heterogeneous regulatory landscape is also a major challenge for institutions operating across borders. The wealth management industry in particular is subject to cross-border issues spanning tax evasion, money laundering, data protection, information disclosure, and marketing and sales rules – many of which are complicated by digitalization. Unfortunately, the complexities of regulatory requirements in this area limit what can be automated. This drives compliance costs in wealth management up. Putting in place suitable frameworks and policies for staff helps to mitigate the risks, but eventually simplified regulation is needed.


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Dealing with the new dimensions of digital risks
With increasing digitalization, the risk focus is shifting to new areas.

- **The phantom of disintermediation:**
  The Fintech hype has raised concerns that the financial services sector is about to experience widespread disruption. Disruption has already happened in niche areas where FIs were too slow, not sufficiently customer-friendly, too expensive or simply non-existent. Now FIs fear that the rise of new players from outside the industry – in payments, peer lending, robo-advisors and financial management tools – will make the disintermediation threat real.

  However, if we take a look at robo-advisors as an example, this fear may be misplaced. Despite progress in the United States, where Wealthfront and Betterment have made their mark in wealth management, activity in Southeast Asia has been slow to pick up. Korea is the most active Asian market for robo-advisors, with KClavis and Black Numbers launching robo-advisor services to manage a diversified investment plan, including buying and selling shares and ETFs. The popular Korean messaging service Kakao has also introduced a service that provides product recommendations and personalized advice to “KakaoTalk” customers.9

  Despite such initiatives making peripheral inroads, FIs are unlikely to become obsolescent in the near future. Clearly, the industry is transforming and, as always, there will winners and losers. Digitalization will make the financial services landscape more diverse and competitive. With customer expectations changing and loyalty declining rapidly, FIs cannot rely on existing business models to prevail, nor on regulators to protect them.

  Those wanting to avoid the risk of disintermediation have plenty of options. With massive capital reserves, the financial services industry is well-positioned to invest in new ideas, technologies, and partnerships. The challenge will be to innovate for the right reasons – to improve the customer experience and to explore new business revenue models. Unfortunately, the hype around Fintech and digital has triggered a herd mentality, often forcing FIs to act without a clear strategy or understanding of how it will affect value for customers or the organization.

  FIs need to remain calm in the face of the technology onslaught and look at where and how they can use digitalization to their advantage.

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9 FinTech Asia: Insights into robo-advisors, December 2015 at www.fintechasia.net/robo-advisors/
Cybercrime the new number one priority:
As digitalization intensifies FI vulnerabilities, cybercrime is an increasing threat. The financial industry is threatened by a range of increasingly sophisticated and organized attackers, from profit-seeking criminals, to activists with a political or social agenda, to state-sponsored hackers with the objective of compromising customer data or even damaging the integrity of the financial system. FIs are now being attacked by intrusion technologies and techniques, leveraging multiple attack vectors and multiple types of malware to disguise an attack and confuse security analysts.

It is no longer a question of how to avoid being hacked, but how to react to it once it has happened. Although perimeter defenses are crucial to keep attackers out, FIs need to go further to identify, prevent and eliminate the attacks in near real-time as they occur.

This means FIs need new methods of threat detection, analysis, and elimination as well as clear frameworks and action plans that govern the reaction in case of a breach. Keeping pace with cyber threats will require organizations to be more proactive and collaborative and start to think not just beyond the known and unknown risks of today, but also those appearing on the horizon.

The challenge is to find the right balance between security and customer convenience. Eventually, biometrics is widely anticipated to end the insecure yet very common practice of password/PIN authentication. In future, security will not just include checking an individual's fingerprints, face, retina, iris and hand – but their voice patterns, handwriting and keystroke dynamics as well. This combination of physiological and behavioral features is considered the best means of reducing fraud. Although the technology has been around for years, FIs are just beginning to take baby steps. For instance, banks in Australia, Malaysia and Singapore are using smartphone fingerprint sensors to authenticate payments or online banking access.10

The data security challenge:
In the digital world, safeguarding data privacy and minimizing the risk of data loss are key concerns for FIs. In the last five years, Singapore, Malaysia and the Philippines have introduced comprehensive data protection regimes similar to those in Australia and Hong Kong.

As the industry moves towards service-based operating models, FIs will have to develop the adequate frameworks and capabilities to manage data security in third parties. Already, managing outsourcing providers has evolved into a comprehensive task spanning provider selection, clear contract and service-level formulation, proper risk management practices and due diligence processes, crisis protocols, and regular assessments on the threats and vulnerabilities of the system. Although a robust contract can require the third party to obey all laws and regulations and oblige them to allow regular audits and reviews, the real challenge lies where these clauses have to be controlled and enforced. According to regulations, the responsibility ultimately lies with an FI, which may lack the expertise and means to perform regular reviews and audits, or enforce changes to the service provider’s systems, policies, procedures and controls.

Industry collaboration to facilitate third-party management through standardization, certifications and trusted third parties to carry out audits will help to mitigate the cost of and enforce vendor compliance.

Emerging vendor risk – a new discipline?

Working together with fintechs may combine the best of both worlds; however, it also comes at a risk for FIs. Start-ups have innovative ideas, but they often lack the internal controls or regulatory sensitivities of more established players. Their narrow solution focus can also become a burden if the business model is not sound. The availability of investment capital allows some start-ups to grow without a sustainable business model. We see a real risk that, once the next tech bubble bursts, many fintechs will exit the game, leaving their partners exposed.

Identifying the right start-up partner is crucial to avoid reputational damage or regulatory repercussions. Besides the innovative idea they are buying, FIs must also consider security, privacy and commerciality.

Reputational risk – an uphill battle:

In recent years, we have seen established, reputable service providers facing crises caused by system outages and stolen customer data. Any FI in this type of situation will quickly find themselves in the headlines, with the potential for massive damage to their brand and customer trust.

Digital transformation also comes with an intrinsic reputational risk. Moving towards virtual organization will force FIs to restructure their workforce, resulting in high-profile and unpopular retrenchments. Likewise, once branch networks start to consolidate, as we have seen in many mature Western economies, banks will face opposition from customers. Also, now social media is the megaphone for unhappy customers, the reputational damage of complaints going viral is a growing area of risk.

A good reputation must be actively built and managed to achieve resiliency in the face of adverse events. This means transparency and presence in social media and the mainstream media before disaster strikes. Strong cybersecurity governance, robust incident resolution plans and simplified communications also play a significant role in damage mitigation.

Start-up vendors are not likely to have the adequate risk and controls. We have seen that some small digital companies have zero experience and are rather naïve in their approach. That's where banks can add a lot of value.

David Gledhill, DBS
What must financial institutions do to succeed in the age of digital transformation?
FIs need to adapt or risk being swept away by an onslaught of digital players and technologies and the increasing demands of digitally sophisticated customers. Keeping pace will present costs, challenges, and risks, as FIs will have to rethink the way they operate on various levels – from customer experience, to organizational culture, to business models. However, FIs have no alternative, as the digital transformation is already picking up speed.

When developing or refining their digital strategy, FIs should consider:

1. **Who is it for and what is needed?**
   Organizations need to develop a much deeper understanding of their customers and build a value proposition that addresses the needs of the target audience. Demographics cannot deliver this, FIs need a deep understanding of behaviors, attitudes and perspectives. Every new design and development should start with the customer and work back, focusing on their experience, needs and satisfaction.

   **How EY can help**
   We can help you put in place outside-in methodologies, capture deep and unbiased customer insights, and develop new strategies for attracting, engaging, and retaining profitable customers. Leveraging our knowledge will also help you move to a seamless, interactive omni-channel experience. We can support the capability build, cultural change, and change management to deliver these experiences.

2. **How can digital be monetized?**
   Digital channels should not be cost centers. Every interaction or initiative must drive value in the form of a better customer experience, revenue growth or both. This requires a new approach to product development, distribution, staff capabilities and organizational culture. Existing products and business models cannot deliver a rich digital experience – simply making them available online is just a cosmetic change. True digital transformation is much more disruptive.

   **How EY can help**
   We can help you to develop, test, and deploy new business models, for instance, by leveraging new technologies such as consumption-based pricing or robo-advisory. We can also support you in deploying new operating models, such as asset-based services and managed services to reduce cost and manage IT more efficiently. Our specific portfolio management approach to digital transformation, will allow you to identify the right mix of sustaining, adjacent, and disruptive innovation on the basis of your growth ambitions and risk profile.

3. **How can we deliver a digital experience in the most efficient and productive way?**
   The future is real-time, relevant, personalized, and interactive. Delivering this experience requires a modernized organization with fully automated processes and driven by data – geared for speed and customer centricity. New methodologies will accelerate the conceptualization, design, and testing of digital solutions, but common sense and proper control policies will safeguard the process.

   **How EY can help**
   Working with EY will speed your time to market. We’ll help you to identify the right type of innovation through ideation workshops, co-creation and smart processes. Using our proprietary “Agile Innovation” methodology, we will help you develop the capabilities, process frameworks, project management skills, and controls to increase likelihood of success. With our support, you’ll build a coherent and effective innovation network that can identify great ideas and commercialize them quickly. We can create an internal innovation network that engages your employees and tap into an external innovation ecosystem, including clients, leading innovation experts, business partners, and the rapidly evolving start-up community.

4. **How do FIs manage risk and compliance in the process?**
   Regulation will continue to move at a slower pace, as it lacks the resources, expertise, and mandates to stay on top of every new emerging technology. The challenge for FIs is to revise the role of internal legal, risk, and compliance teams to be innovation partners and ensure digital initiatives can move forward in a balanced way.

   **How EY can help**
   We can help you put in place the right governance frameworks and controls to manage end-to-end digital transformation from deploying agile methodologies, to managing third-party risk and performing audits. To address the growing threat of cybercrime, we can guide you through the maze of new solutions and approaches, including: cyber threat intelligence, cyber program management, security operations centers, identity and access management, data protection programs and achieving resilience in the cyber ecosystem.
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Research methodology
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