

FORUM INSIGHTS

# Leadership and Governance in the Next Normal



DECEMBER, 2022

# About FIDE FORUM

FIDE FORUM was established as an exclusive community for financial institutions (“FI”) Directors in Malaysia. With our tagline ‘For the Members, By the Members’, we leverage on the collective wisdom, experience and strength of our members to co-create value with FI boards in delivering holistic and pragmatic board-centric solutions. Since its launch by the then Governor of Bank Negara Malaysia (“BNM”), Tan Sri Dato’ Sri Dr Zeti Akhtar Aziz in 2012, the non-profit alumni association representing 83% of FIs in Malaysia today, is uniquely positioned to represent the voice and serve the needs of Directors in Malaysia’s financial services sector.

## **BOARD MEMBERS**

Tan Sri Datuk Dr. Abdul Samad Haji Alias  
Datuk Kamaruddin Taib  
Ms. Pushpa Rajadurai  
Encik Nizar Idris  
Mr. Choong Tuck Oon  
Mr. Ou Shian Waei  
Mr. Adil Ahmad  
Ms. Che Zakiah Che Din  
Ms. Ong Ai Ling (*Retired on 23 June 2022*)

## **CHIEF EXECUTIVE OFFICER**

Mr. Tay Kay Luan

## **VISION**

To be an exclusive network for FI directors to enhance board excellence for sustainable business growth and financial stability.

## **MISSION**

To provide seamless board services to enhance FI directors’ awareness, board talent and board effectiveness by leveraging on though leadership and insights of Members.

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# Introduction by Chairman

Tan Sri Datuk Dr.  
Abdul Samad Haji Alias



## Chairman of FIDE FORUM

Welcome readers to the first issue of the Forum Insights. It is part of FIDE FORUM's education proposition to enhance board awareness and thought leadership. Research and insights into the future themes and trends in the global business of finance are integral part of information services allowing the alumni association to stay focused, so as to enhance its relevance in propelling the corporate governance agenda forward.

Forum will harness its research capacity and translate its applied business intelligence to drive its agenda, enabling deeper strategic value to members. This involves capitalising on the rich wealth of industry knowledge and experiences to further shape the value of the future.

## Navigating through a VUCA Environment

The theme of the first issue of the Forum Insights is "Navigating through a VUCA environment". The concept VUCA which stands for **V**olatile, **U**ncertain, **C**omplex, and **A**mbiguous, was first coined in the late 80s. The concept remains more relevant, in today's context of a difficult and often unpredictable environment of disruptions to global business. The post Covid-19 pandemic witnessed impacts of Ukraine conflict that brought adverse impacts to the global supply chain resulting in the rising cost of energy, and cost of living adding to the growing threats of possible economic recession.

It is worth noting that the list of ongoing global disruptions from geo-political risks, climate change issues to digital change continues to pose challenges for many. These challenges will necessitate the need for industry players to be aware, agile and be better prepared. The Forum Insights put these into context, shares perspectives that reflect, reconceptualise the issues, and reiterate the importance of resilience, governance and lessons that can be learnt from the past.

This issue starts with an article from the Governor, Bank Negara Malaysia that defines the Governance Priorities of Boards in the Next Normal. In line with the post-pandemic recovery, the article reminds industry that good governance will come with an uncompromising culture of ethics, integrity, and compliance. While this is necessary to navigate the challenges, the opportunities of the future cannot be ignored. The message from the article reemphasizes good governance from the top, as well as having in place strong pillars of governance will involve sound culture, appropriate and effective incentive structures, towards building necessary accountability frameworks and consequence management to manage risks.

Supporting the strong framework comes a recall of the socio-economic risks that include perspectives on systemic risk of climate change to the financial system and other relevant environmental, social, governance and technology matters. It is also vital for the board of financial institutions to think in terms of multiple possible scenarios of emerging trends and have a good understanding of the issues, risks and opportunities facing the organisation, so that the board can envision the roadmap amidst the chaos. More importantly, the board will need to learn to be adaptable in this rapidly changing environment and muster the courage to apply the relevant strategies (sometimes unpopular but effective ones) to navigate the organisation in this VUCA environment.

Forum Insights welcomes feedback from its readers. We like to take this opportunity to extend our utmost gratitude to the Governor of Bank Negara Malaysia for her unwavering support towards the launch of our inaugural Forum Insights and fellow distinguished authors for contributing to the success of our Forum Insights publication. We thank you for your readership and see you in the next issue!

In such context, scenario planning becomes a necessary tool for business strategy and decision-making in this VUCA environment – that the same winning strategies of the past will not guarantee success in the future but may in fact be detrimental to the organisation should the same strategies be applied today. Board members and leaders of the organisation may have to forgo the Business-As-Usual (BAU) attitude.

The Forum Insights continues with current development and trends on board composition. The need for board diversity in this aspect has received attention from financial institutions. The article demonstrated a case where board diversity can play a leading role in creating a more stable corporate governance. The need to change attitudes is one, but more importantly the recognition that there is a link between good governance and diversity.

Having in place the necessary change to overcome the VUCA challenge reinforces the need to embrace new internet technologies (dubbed Web 3.0) and their potential disruption to the traditional financial institutions. The narrative on technological change needs no reminder, as automation on delivery processes will continue to shape the way financial institutions interface and interact with customers.

Forum Insights shares a first-hand in-depth insights and lessons learnt from the past vis-à-vis the Asian Financial Crisis (AFC) through the operationalisation of resolution and recovery of banks, using the merger and corporate exercises of RHB Banking Group as a case study. Following the lessons from the AFC, the Malaysian economy was more prepared and hence was able to turn around quicker during the Global Financial Crisis (GFC) compared to its western counterparts.

# 01

## Governance Priorities of Boards in the Next Normal

by Tan Sri Nor Shamsiah  
binti Mohd Yunus  
Governor of Bank Negara Malaysia

# The financial sector is the life blood of the economy.

**It** helps individuals and businesses grow their wealth, make payments, own a home, grow their enterprise, manage financial risks and adverse events, create high quality jobs, and other economic outcomes. Ultimately, the aim of finance is to support economic growth and transformation, and in turn, improve lives and livelihoods.

by **Tan Sri Nor Shamsiah  
binti Mohd Yunus**

Governor of Bank Negara Malaysia

While this point might often be taken for granted, it is important for the leadership and governance of financial institutions to be founded on a deep appreciation of the role of finance in the economy. Unless this is well understood by every individual member of the board, it is hard for financial institutions to live up to the purpose of finance, which is to serve as custodians of public funds and advance outcomes in the best interests of the economy and society.

It is for this reason that financial institutions, especially banks, are expected to be well run and have strong foundations. The governance standards expected of financial institutions are correspondingly higher than that expected of businesses in many other industries.

This recognises that the commercial objectives of financial institutions may not always clearly line up with the interests of the economy and society, raising implications on broader financial and economic stability. Of note, the failure of financial institutions, especially large and systemically important ones, casts negative impacts on many – not just depositors whose life savings are put at risk, but also those who depend on their critical services such as payments and credit, inducing shocks and stress on the economy.

**Financial** institutions also play a critical role in supporting the broader economy and society through tough times. To illustrate, during the pandemic, the financial sector stepped up to implement measures to help businesses and individuals weather the difficult period, ranging from offering repayment assistance to supporting quick insurance pay-outs. These measures were critical in supporting a swift and firm economic recovery from the significant impact of the lockdowns. More importantly, the financial intermediation process continued and there was no credit crunch. Throughout this period, the boards and management of financial institutions had an instrumental role in steering the response of financial institutions during an enormously challenging time for the country. The pandemic has also reminded us of the need for boards to provide effective challenge from a wider lens, beyond immediate commercial and financial considerations.

As the world moves to the “next normal”, good governance built upon an uncompromising culture of ethics, integrity and compliance will continue to be key. This will help the Malaysian financial sector navigate the challenges and opportunities of the future. Good governance must start from the top, and is ultimately preserved over time through an unwavering commitment to continually strengthen the pillars of governance and sound culture. This includes ensuring appropriate and effective incentive structures, succession planning, codes of conduct and accountability frameworks and consequence management.

**In** addition to addressing the immediate macroeconomic challenges today, boards will need to increase their capacity to provide effective strategic direction and renewal in the “next normal”. This means building agility within boards and senior management to respond to sudden changes and surprises, such as the many we have seen in recent years relating to rapid technological change, increasing cybersecurity risks, demographic shifts or climate change. This must be done while leveraging opportunities to strengthen their business relevance and competitive advantage. As boards are responsible for providing effective strategic direction and oversight over the affairs of the institution, it is important for boards to stay abreast of issues, and for individual board members to leverage their outside perspectives and experience to raise the quality of discussion with senior management in shaping and driving strategies to future-proof their institutions.

Boards will also need to raise their capacity to confront and respond to crises. The COVID pandemic was an unprecedented crisis in our modern history, but it will not be the last. Important lessons and reflections should be drawn for boards and management – to better clarify their respective roles and how they would work together, and to identify their stakeholders and how they should manage their relationships during crises. Striking the right balance between preserving important checks-and-balances and enabling swift responses would also be essential during periods of stress. Finally, boards must be willing to execute the recovery and resolution plan to recover or restructure the institution if the need arises, to minimise disruption to the financial system.





This requires boards and management to foster relationships that engender trust and candour that can ride through both good and challenging times. Boards need to be more intentional in nurturing healthy boardroom dynamics that will support timely and quality decision making during crises. This cannot be taken for granted, but requires deliberate and sustained efforts that will survive changes in individual board members and management teams.

Beyond the institution, there is also room to strengthen and clarify governance arrangements at the industry level, to enable more coordinated and swifter collective responses. After all, in a crisis, time is of the essence. During a crisis, the ability of financial institutions to come together through industry associations to bolster public confidence has been a key factor in the successful management of crises. The industry should be clear on the role of industry associations during a crisis and ensure that governance and operational frameworks, both at the association and individual institution level, are consistent with those roles.

Circling back to where I started, boards must not lose sight of the important role that financial institutions play in the economy. This should drive a clear focus on long-term value creation. Indeed, boards are expected to provide direction and oversight over the business and affairs of a financial institution, with the view to promote the long-term viability of the institution.

Defining a financial institution's corporate purpose clearly and succinctly and overseeing business strategies, plans and a corporate culture that is aligned with that purpose goes to the very heart of good governance that will endure the test of time. After all, society today demands more of financial institutions than ever before; society today not only expects financial institutions to be good stewards of their funds, but to also act responsibly to address pressing challenges of our time, such as those relating to climate change and sustainability. These are not just passing fads, but important priorities for the boardroom agenda. Boards need to ensure that their institutions are appropriately protected against climate risks. They should also reflect on what financial institutions – given their special place in the economy – can do to help the economy and society realise sustainable development outcomes.

As we look ahead, boards face the complex and challenging task of navigating their financial institutions through new and difficult terrain ahead. This is far from an easy task, but it is a vital one to promote a sound, progressive and inclusive financial sector that serves Malaysia well.

Consistent with our commitment to creating a sensible regulatory environment that helps advance good governance, Bank Negara Malaysia will continue to support efforts and contribute to conversations in the endeavour to promote stronger boards. Our hope is that through their leadership, boards will help their institutions fully realise the purpose and potential of finance to serve the economy.

As such, the launch of the FIDE FORUM Journal – as a platform to share ideas, observations and experiences in the pursuit of good governance – is indeed a timely and welcomed endeavour.

# 02

## Climate and Inclusivity Risks: The Role of Financial Institutions' Boards

by Tan Sri Andrew Sheng

Pro-Chancellor of Bristol University  
Distinguished Fellow, Asia Global Institute,  
University of Hong Kong

# Prior to the pandemic in 2020,

by Tan Sri Andrew Sheng

Pro-Chancellor of Bristol University  
Distinguished Fellow, Asia Global Institute,  
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**It** was fashionable for risk managers to talk about a volatile, uncertain, complex and ambiguous (VUCA) world. Risk management has been an important part of corporate governance since the 1997 Asian Financial Crisis (AFC), when financial institutions (FIs) became aware that not only should they focus on their risk management models and processes, but it was also vital to sustain corporate governance and the risk profile of their borrowers.

This paper reviews a broad spectrum of risks in the post pandemic era, involving not just financial risks but also emerging risks from climate disruptions, and focuses on what FIs must know, do and overcome. Drawing from a number of survey findings and recommendations, the paper shares its perspective on what boards of FIs must focus on, adapt to or even reinvent in their business models to support risk mitigation actions. The paper considers the issues, lessons learned and appropriate actions that must be undertaken as a reminder to readers that business as usual (BAU) is no longer viable and complacent mindsets will cause business and reputational failures, some of which could be fatal.

# Changing Global Risks

**The** 2020 Covid-19 pandemic added multiple layers of complexity to an already fragile global economy. Global business was already straining from growing geopolitical tensions affecting supply chains, rising social inequalities, technological disruptions, climate change and changing demographics, including migration, when the health lockdowns forced all businesses to rethink their very survival. As the pandemic receded to an endemic, the hesitant recovery was torpedoed by the outbreak of the Ukraine war, which sparked off food and energy inflation and further disrupted supply chains, exacerbating poverty and the threat of debt distress in 60% of countries which had reached sustainable debt limits.

Unfortunately, the pandemic accelerated the health, wealth and tech divides. At the start of 2022, 50% of the world's population remained unvaccinated while 40% remained offline. The top 1.1% of the world's population held 45.8% of global household wealth, whilst between 75 million and 95 million additional people could be living in extreme poverty in 2022 compared to pre-Covid-19 projections, due to the lingering effects of the pandemic, the war in Ukraine, and rising inflation. In essence, the 2008 Global Financial Crisis (GFC) plus the pandemic and Ukraine war have cumulatively pushed inequality and democracy back to roughly 1990 levels. With the massive quantitative easing expansion in liquidity during the pandemic, asset prices rose sharply whilst labour income dropped, so inequality both within countries and between countries has widened. Rising social polarization led to governments being elected with reduced majorities and even less capacity to deal with crises structurally and decisively.

Democracy is about delivering the greatest good for the greatest number, but as we have seen, the micro, small and medium enterprises (MSMEs) are the worst hit, because they do not have the resources, know-how and capital to withstand the disruption to cash flow, growth in debt and rapid shift to online as compared to large multinationals with deep pockets and access to capital markets and bank finance.

The World Economic Forum's (WEFs) *Global Risk Report 2022* noted that the pandemic has worsened societal and environmental risks the most, with 'social cohesion erosion' and 'livelihood crises' taking the top spots. Other worsening risks include 'debt crises', 'cybersecurity failures', 'digital inequality' and 'backlash against science'. The risk survey was conducted before the Ukraine war, meaning that the situation could have worsened since the report was published. As much as 89% of surveyed WEF members perceived the short-term outlook to be volatile, fractured or increasingly catastrophic, whilst 84% were concerned or worried about the future, fearing a cycle of disillusionment that would make policy reform even more challenging.

The situation for most emerging market and developing economies (EMDEs) are dire. Commodity prices have increased by about 30% since end-2020, with higher oil and gas prices benefitting producers, but devastating energy importers. Food prices are sharply up because of cuts in supply from Ukraine and Russia, both of which account for just under 10% of global grains and food production inputs. Global public debt increased to 97% of gross domestic product (GDP) in 2020. Global private debt surged by 13% of world GDP in 2020 — faster than the rise seen during the 2008 GFC and almost as fast as public debt. Debt overhangs will not only slow overall growth, but also put many companies and governments into debt distress.

Given all these uncertainties, businesses have cut back on long-term investments, and the war has diverted attention away from policies aimed at net zero and climate change. Rich countries are less generous with aid, whilst trade prospects are gloomier with increasing tariff wars, sanctions and supply chain decoupling. Furthermore, the employment situation is dire at both ends – digitising companies find it hard to get workers with high tech skills, whilst the supply of labour was cut as many workers refused to return to office for work, after prolonged lockdowns with work from home.

The latest situation on the climate change front is that encouraging. The recently concluded 27th United Nations (UN) Climate Change Conference of the Parties (COP27) in Egypt basically concluded that the world will not be able to meet the 1.5°C goal established at the 2016 Paris Climate Agreement. There was some agreement that the rich nations should fund some “loss and damage” to African countries due to colonization and climate damage to their economies. Nevertheless, there is considerable uncertainty on how the world will be able to fund the huge energy restructuring exercise to reach net zero, since many countries are already facing debt distress or a lack of fiscal capacity arising from inflation, recession, war or internal conflicts.

The shift towards digitisation was accelerated by Covid-19, which necessitated a massive shift to remote work, adoption of artificial intelligence (AI), Internet of Things (IoT), networking of robotic production, blockchain, 5G and cybersecurity. In the context of increasingly complex digital systems, growing cyberthreats are outpacing societies' ability to effectively prevent and manage them. Malware increased by 358% in 2020, while ransomware increased by 435%. In 2021, UK internet banking fraud rose by 117% in volume and 43% in value compared with 2020 levels, as people spent more time shopping online. In December 2021, the Oversea-Chinese Banking Corporation, Ltd (OCBC Bank) reported that up to 469 people had fallen prey to phishing scams, with reported losses totalling at least US\$8.5 million. In 2022, 650 customers at CIMB Group Holdings Bhd (CIMB Bank) sought to recover roughly RM1 million in losses due to the bank's processing errors.

While interconnectivity and technology helped governments manage the pandemic, many low-income countries run the risk of being left behind in the digital divide. The digital divide comes from an acute shortage of experts, with over three million cyber professionals needed worldwide as 95% of cybersecurity issues were traced to human error.

Anyone who adds up these entangled risks will realise the changing context faced by small- and medium- enterprises (SMEs). Under such circumstances, FIs are faced with not just black swans, namely events of low probability but high impact, but also grey rhinos, issues that are already identified but must be addressed frontally. Boards face the challenge of identifying the right risk model and governance structure. Public interest must be addressed within its business model by addressing its social, ecological and governance values and operations.

Under such wide-ranging risks and limited options, the board must be more focused and strategic and not try to do everything, but determine what is most important, fix basic problems and then create the team to execute the corporate vision and mission.

In essence, the board must have a good, diverse background, be experienced in environmental, social and governance (ESG) issues as well as technology, gender, politics and geopolitics to be able to decide not only on business strategy, but also social agenda, environmental affairs, human resources and business operations. Boards will have to undertake SWOT (strengths, weaknesses, opportunities and threats) reviews as well as PEST (political, ecological, social and technological) exercises, including strategic scenario building involving all key stakeholders in order to decide how to meet the complex challenges of the 21st century.

Businesses, communities and governments have entered into a new world disorder with a business model and mindset paradigm that may be irretrievably broken. No board can afford not to pay attention to existential issues of survival, regulation, technology disruption and geopolitical threats.

Crises are events, but managing change is a process in which only through experimentation (thus by definition, taking calculated risks) can companies slowly unveil what works and does not. That process is complex, since it impacts the chain of processes involving environment, social, governance, policy and regulation. Each need to be dissected in parts, but there must be a holistic way in which the board assesses all risks cohesively, evaluates and then prioritises what the company values in terms of ethics and social responsibility. Only then can the board decide how the business plan should be executed, including whether the existing management team is able to execute such a plan.

# Managing Risks and Not Forgetting Opportunities

**Since** the AFC, the corporate and regulatory world has been preoccupied with credit risk management, often forgetting that risk and opportunity are two sides of the same coin. Asymmetry between risks and short-term disclosures resulted in companies and regulators becoming too cautious and they may have missed huge opportunities in the long term. Board members, therefore, must be careful to avoid the possible tragedy of horizons, where focus on the short term is at the expense of ignoring structural shifts in the long term. It is too easy to focus on the urgent short term rather than the important long term trends which, slowly but surely, are underway without most people being aware that the game has changed.

## a Climate Change

**Prior** to 2015, business was in denial over climate change, considering sustainability, like compliance with regulations, to be a cost rather than an opportunity. However, as consumers became much more green and ecologically aware about the increasing pollution in air, water and occurrence of natural disasters, there was a fundamental shift in mindset. Part of it arose from a greater shift in the discourse regarding climate because of the UN's work on the sustainable development goals (SDGs), including the UN Intergovernmental Panel on Climate Change's (IPCCs) expert reports that indicated the world is running out of time available to deal with climate change and global warming. The pandemic accelerated public awareness that health is closely associated with changes in the natural habitat, as human beings living closely with animals enabled zoonotic transfer of viruses from animals to humans. As the younger generation become more activist in demanding climate action, consumers began to demand more transparency about the carbon footprint of the products that they buy. Consumers are willing to pay more for organic or natural products, such as coffee or health foods, pushing companies to act more sustainably and ethically in the production of 'green' and safe products.

Thus, instead of hiring lobbyists to change regulations in their favour, as done by the tobacco or petrochemical companies, there is a movement within multinational and domestic companies to make their products and services green, sustainable and more inclusive, which includes changing their governance structures and operations to meet higher ethical standards.

By 2021, one-third of global consumers actively reduced their emissions and one-quarter used carbon offsets to compensate for them. Predominately young and relatively affluent, climate-minded consumers are a force to be reckoned with. Products with transparent, low-carbon-footprint supply chains are winning the wallets of climate changers. There was a surge in home gardening during the pandemic as consumers searched for new self-sustainable and eco-friendly hobbies, which created a new group of 'rural' urbanites. As more consumers were able to work remotely, some urbanites relocated to the suburbs for more spacious housing and greener scenery. Successful businesses, therefore, are responding by incorporating sustainability and green activism into their strategies.

Meanwhile, expanding e-commerce is another vital part in sustaining revenue growth and the loyalty of existing customers. Circular business models that recycle waste and minimise energy and raw materials will become increasingly important. Going forward, many companies will prioritise productivity, digital acceleration, customer engagement and employee well-being.

The result of this is that boards will now have to take into consideration the well-being and healthcare of all stakeholders – consumers, staff and society as a whole. In short, they will need to use technology and latest thinking in order to achieve their ESG goals. Boards have a key function in corporate transformation towards a sustainable and equitable economy.

As managing daily routines at work, home and external engagements in the post-pandemic era will be different, the post-pandemic world presents an opportunity for many companies to refresh and rethink their roles with regard to sustainable development, including the battle against climate change. As 80% of carbon footprint and resource usage are determined at the design stage, companies will need to lead in designing, producing and distributing the next generation of green, sustainable products and services in a circular economy of 'make-use-recycle' rather than the old 'make-use-waste' model.

The European Commission pioneered and promoted the concept of a circular economy based on the 3R concept of reduce, reuse and recycle. WEF estimates that this is a potential billion-dollar business that can help create new jobs and sustain the global economy.



# b Inclusivity

**A balanced** society is one in which society shares and cares for those who are disadvantaged by unequal access to education and resources or due to their gender, race or class. Society will be polarised when income, wealth and access to opportunities are distributed unequally. The pandemic worsened such access as the rich grew richer and the poor fell ill or died because the latter did not have access to proper healthcare, technology or income.

According to *Harvard Business Review*, four million Americans left their jobs as of July 2021 in what is known as the Great Resignation as the pandemic forced consumers to reconfigure their lives and prioritise mental stability amidst health risks, economic hardship and isolation. Employees are starting to think differently about their careers based on changing living situations, family dynamics and life priorities. Several key underlying trends will shape workplace volatility in 2022. Employee turnover will continue to increase as hybrid and remote work become the norm for knowledge workers.

Wellness will become the newest metric that companies use to understand their employees. Diversity, equity and inclusion outcomes will be demanded by workers and society. According to McKinsey, the business case for inclusion and diversity (I&D) has been steadily on the rise. Diverse companies are more likely to outperform industry peers on profitability.

McKinsey draws five best practices of diversity leaders that can help strengthen inclusion in companies:

- 1 Ensure representation of diverse talent;
- 2 Strengthen leadership accountability and capability for I&D;
- 3 Enable equality of opportunity through fairness and transparency;
- 4 Promote openness and tackle micro-aggressions; and
- 5 Foster belonging through unequivocal support for multivariate diversity.

Specifically, under-representation of women in the workforce and at executive levels has proven to be a drag on performance because, in recent years, women have risen considerably in terms of income, purchasing power, education and political voice. Globally, most countries have low female representation on executive teams with developed countries, on average, having higher rates of diversity representation than emerging economies. Gender balance on boards and in senior management not only encourages better leadership and governance, but diversity further contributes to better all-round board performance and, ultimately, increases corporate performance for both companies and their shareholders. Data show that executive teams with more than 30% women are more likely to outperform those with fewer or no women present. Boards will have to have a clear gender and inclusivity agenda and action plan in order to meet global ESG standards. Investors, lenders, consumers and the community at large will be watching which companies are willing to walk the talk of inclusivity.

## C Technology Shift

**Technology** is clearly the big trend in a post-Covid world. The pandemic drove consumers to online channels due to the movement restrictions and requirements to work from home. A 2020 McKinsey survey showed that online purchases grew by 15% to 30% in the US. This change in consumer behaviour arose because lockdowns made people pay more attention to their personal well-being and increased the desire for a better lifestyle. More online shopping led to increased demand for delivery services. Advertising has shifted from physical on-site visits to the use of augmented and virtual realities and, more recently, to immersive virtual worlds known as the metaverse. These technological advancements have spread worldwide as smartphones enabled new forms of immediate advertising as well as payments and settlements.

Increasingly, consumers and small businesses want more control over their bank transactions. Online banking is rapidly evolving to allow customers to make financial transactions, such as online payments, loan applications and opening of savings accounts, among other types of digital transactions. The demand for digital functionality has meant that banks, insurance companies and fund managers need to meet the competition from financial technology (fintech) start-ups and giant technology platforms head-on. Many banks have adopted the omni-channel approach in terms of delivering services to customers across digital and offline channels.

The arrival of blockchain technology has improved data security, whilst artificial intelligence, Big Data and analytics have improved both the assessment of trends and the competitive advantage of companies that offer a better response to consumer tastes. These are increasingly being shaped by virtual and augmented realities that give consumers a 'metaverse' experience of their new product, such as a car, house or travel experience. Thus, no business, especially finance, is exempt from investing in technology and the corresponding talents to manage such technology.

This acceleration means that FI boards not only have to understand technology, but also build the teams that are able to design, implement and operate omni-channel deployment, putting a huge stress on the current staff who are likely undertrained in technology. In the future, there will be no e-commerce, only commerce that is fully digital and physical at the same time. Thus, the board must have members who are conversant with technology, including how technology platforms operate and compete. Many conventional FIs have found that their market share has dropped considerably in different market segments without realising that their competitors, from both mainstream institutions as well as start-ups and tech platforms, are able to 'eat their lunch' using new forms of technology that deliver services at greater speed, scale and scope. Banks are already finding that fintech can encroach on payment systems, lending and market share with more nimbleness than mainstream banks and insurance companies.

# d National Security

**Until** about 2015, national security was not high on the priority list of FIs. But with growing geopolitical rivalry between the US and China, as well as the Ukraine war, when financial sanctions have been weaponised against Russia, FIs have to pay serious attention to not just cybersecurity and regulatory compliance, but also supply chain disruptions arising from civil conflicts or war.

For example, almost all levels of key infrastructure need resilient and secure supply chains to ensure the development and continued function of defence capabilities crucial to national security. The US Department of Defense has focused on four areas that are critical to defence supply chains, such as kinetic capabilities in developing advanced weapons; energy storage and batteries; high-capacity batteries with a particular focus on lithium batteries; and key metallurgy manufacturing processes and microelectronics. These capabilities involve strategic or critical enablers, such as workforce skills, cyber capacity, manufacturing practices, use of small businesses in supply chains, building domestic production capacity, engaged partners and allies, and mitigating foreign ownership, control or influence.

The financial sanctions on Russia forced FIs to scramble and catch-up on the implications to their reputation if they are caught violating sanctions, plus severe damage to their business if they are cut off from vital infrastructure such as the SWIFT messaging network or multicurrency clearing and settlement systems. Major banks have already paid billions of dollars in settlement costs in cases where their due diligence of politically sensitive clients and customers failed to capture sanctions violations. At the same time, rising war, conflict and natural disaster risks are disrupting key infrastructures involved in the financial and real supply chains. No FI can afford long-term disruptions to quality service for clients.

In short, boards will have to pay more attention to national security needs and build more resilience and adaptability into key infrastructures, including staff capacity, to deal with all types of crises or network disruption.

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## Cybersecurity

**With** cyberattacks growing in speed and scale, companies need to take measures to protect their business as well as clients. Half of the world's cyberattacks are targeting small businesses that usually don't have sufficient cybersecurity measures. Based on a 2020 survey, the most common cyberattacks experienced by US companies are phishing (38%), network intrusion (32%), inadvertent disclosure (12%), stolen/lost device or records (8%), and system misconfiguration (5%).

The steps that organisations can take to strengthen their digital security include investing in capacity and capabilities to meet market demands. For example, strengthening the security of IoT and mobile devices. Computing devices embedded in IoT products allow the sending and receiving of data over the internet, posing significant security threats to users by exposing them to cyberattacks such as hijacking of devices. Mobile devices are becoming a great channel of opportunity for cybercriminals as users continue to use their mobile devices for personal and business communications as well as banking, shopping, flight or hotel bookings.

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## Anti-money Laundering and Counter-terrorist Financing Standards

**The** Financial Action Task Force has set out a basic framework for countries and the private sector to address money laundering from environmental crimes.

They have also listed a detailed definition of money laundering from selected environmental crimes, which include illegal logging and land clearance, and illegal mining and waste trafficking, due to the significant criminal gains involved and their convergence with other serious crimes.

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# Impact of Sanctions

**Sanctions** are strategic tools used to restrict economic flows, such as capital flows, resource flows, trade flows or data flows, in order to achieve a desired outcome in the target country. Sanctions have three stages of seriousness:



Threat  
stage



Signalling through  
sanctions targeting a  
specific area



Economic warfare,  
i.e. when sanctions are used with  
the goal of weakening an  
economy and decoupling it from  
global economic flows

As the US dollar is central in the global financial architecture, the US has effectively used anti-money laundering and anti-terrorist measures in the war on terror.

The financial sanctions on Russia, including the freezing of foreign exchange reserves and denial of usage of SWIFT and other clearing mechanisms, plus the seizure of Russian oligarchs' assets, mean that FIs must be alert when conducting their due diligence of customers and the consequences of violating any sanction regime.

Incidences such as 1MDB that have cross-border implications means that customers of FIs could be subject to legal action in other jurisdictions, which will negatively impact its reputation with serious consequences to its ability to perform cross-border transactions. Board members should therefore be sensitive to these risks and ensure that the FI is capable of monitoring and managing its national security risks.

## h Environment

**In** 2012, the UN designed 17 high-level SDGs to replace the previous millennium development goals. The SDGs were adopted at the UN summit in 2015 for the purpose of achieving a sustainable, diverse and inclusive society by 2030, but translating these into ESG, where standards have not been fully articulated, is a monumental task. The corporate sector has a key role in implementing ESG investments because this is a whole-of-society endeavour.

At COP26 in Glasgow in November 2021, it was broadly agreed that advanced countries would achieve carbon neutrality by 2040 and net zero by 2050. Carbon emission commitments dominated discussions during COP26, since the world needs to attain net-zero emissions by 2050 to avert some of the worst impacts of climate change. The IPCC has found that carbon dioxide emissions need to fall by about 45% from 2010 levels by 2030 in order to have any hope of achieving net-zero emissions by 2050. China pledged to achieve carbon neutrality by 2060 and India by 2070.

The Glasgow Financial Alliance for Net Zero (GFANZ), chaired by UN Special Envoy for Climate Action and Finance Mark Carney, consists of over 450 financial firms across 45 nations who have aligned their business activities, particularly their lending and investment activities, with net-zero goals. GFANZ members are encouraged to engage climate experts, non-governmental organisations and governments in order to develop clear plans to net zero as well as to advise and support their companies in their own transition plans.

Michael Bloomberg and Mark Carney co-founded the Task Force on Climate-related Financial Disclosures (TCFD) to lift climate-related disclosure from the murky realm of corporate social responsibility to a strategic imperative

This means that FIs will persuade both partner FIs and their corporate clients to take serious action on net zero and ESG issues, including withholding lending or investing in companies that violate ESG standards in terms of both disclosure and performance. In short, all board members should appreciate that achieving the SDGs by 2030 and carbon targets between 2050 and 2070, on top of continued uncertainties regarding war, disruption of supply chains, technology and ESG requirements, is no simple task, but companies must begin somewhere.

The international community has just started looking at ways to standardise and measure ESG investments. The UN System of Environmental-Economic Accounting (SEEA) was adopted in 2021 during the 52nd Session of the UN Statistical Commission and builds on the national accounting report – the System of National Accounts (SNA) – which was approved in 1953, but with the inclusion of ecosystem change. The International Financial Reporting Standards Foundation, which sets global accounting standards through its International Accounting Standards Board, has created the International Sustainability Standards Board (ISSB) to develop an international standard for ecological accounting based on Disclosure Standards.

The ISSB will broadly include existing sustainability reporting frameworks such as the Global Reporting Initiative, TCFD, Value Reporting Foundation and the Climate Disclosure Standards Board. Private financial institutions worldwide have mobilised roughly US\$130 trillion from financial institutions, other lenders and investors to monitor compliance with ESG requirements, meaning that they will decline to lend or invest the millions of companies worldwide and at least hundreds of thousands of companies in Malaysia, to meet ESG standards.

In short, FIs in Malaysia will be asked to 'police' ESG standards that have yet to be fully articulated because of the complexity in 'fitting' local conditions that may conflict with global aspirations. An example is the way in which oil palm company stocks are being 'punished' by asset managers who have reduced their portfolio in such stocks for being non-compliant with workers' rights or ecological standards such as loss of biodiversity and natural-forest clearance.

Essentially, achieving net zero is not just about setting targets. Companies must also lay out clear pathways of how they will reach these goals and they need to act with urgency. Under a moderate climate scenario, up to 80% of S&P Global 1200 companies will be exposed to moderate-to-high physical risks from climate change by 2050. Where governments are not taking the needed policy steps, the private sector is expected to take on more of the burden in leadership and action.

The way in which companies tackle climate change in their business can also influence their credit ratings. Between January and October 2021, out of the 30 ratings changes by S&P Global Ratings on corporates or infrastructures due to environmental concerns in 2021, 27 of these were negative and comprised of 12 downgrades, 11 placed on credit watch with negative implications, and four downward outlook revisions. Markets appear to have rewarded companies that are compatible with a net-zero economy. The S&P Paris-Aligned & Climate Transition Indices, which tracks equities collectively aligned to a 1.5°C scenario and net-zero emissions by 2050, have generally outperformed their market cap-weighted parent indices across all regions.



More enterprises in China are welcoming the idea of integrating sustainability into their business strategies according to a UN Development Programme's (UNDP) survey in mid-2021. It also showed that of the 117 enterprises operating in China, 94.9% are confirmed to have incorporated SDG goals into their corporate action plans. The report also includes an overview of action points, a ready-to-use toolkit and step-by-step instructions for business leaders keen on undertaking a low-carbon transition and aligning with sustainable development best practices. The key points are summarised below:



Different types of companies will have different paths to net zero.



Assessing and reporting SDG impact is lacking. Currently, there is a shortage of expertise to assess sustainability performance as opposed to disclosure. According to a *Bloomberg Businessweek* investigation, the ratings that asset manager BlackRock applies to companies in its flagship sustainable investing fund – the biggest ESG fund in the world – have “almost nothing to do with the environmental and social impact companies have in the world”. Evaluating impact can be difficult without a high-quality database that is compiled transparently and continuously over time, consistent in methodology and accessible to third parties.



Accelerating technological and policy innovation. AI that is currently used to reduce energy use from data centres around the world by controlling systems that keep servers cool and optimise efficiency and carbon capture, utilisation and storage technology continues to evolve. A basic challenge is how to measure such improvements using new technologies and reward companies that move into this field.

The challenges faced by companies that are trying to reach net-zero are similar throughout the world and it will require coordinated global efforts and policy interventions to create incentives and level the playing field. FI boards will do well to collectively work towards defining both disclosure and performance standards that will be practical and not discriminatory against EMDE companies. This means that Malaysian FIs have a role to play in shaping the policy and regulatory framework of ESG standards.



# i Social Issues

**The** Covid-19 pandemic has led to more than 15 million deaths, 120 million people pushed into extreme poverty, deepened inequality divide and set back sustainability efforts. Corporate boards now need to take into consideration sustainability, inclusivity, growth and security (SIGS) issues. Given these wide-ranging demands, in particular the impact on profit and viability, FI boards need to appreciate that going forward, the demands on customers, borrowers and investee companies are more complex than ever.

However, the biggest opportunity as well as threat is the impact to SMEs because they are severely exposed to threats from a multitude of spectrums:



Worldwide, SMEs account for about 99% of firms by number, 70% of jobs and contribute over 50% of GDP in high-income countries. However, when the pandemic hit, about 80% of SMEs across 32 countries lost between 30% and 50% of revenue.



McKinsey showed how SMEs have put business strategies on hold and are now focused on survival, with 29% of SMEs halting sustainability efforts. In many cases, leading firms have passed risks down the supply chain to vulnerable SMEs in developing countries, causing even more job losses and bankruptcies.



Shortage of capital. Unlike large companies, many SMEs do not have access to listing on public stock markets. Crowdfunding is too new for many SMEs to access stock equity. At the same time, global supply chain issues have hit SMEs hard and set back export growth.



Shortage of talent. Many SMEs depend on the talent of the founder or core team of family members, but they lack the right combination of talent and capabilities – especially digital talent – to meet profitability goals as well as comply with ESG demands. They are often unfamiliar with overseas regulatory environments thus restricting their ability to expand internationally.



Shortage of funding. While some governments have made supporting SMEs a priority during the Covid-19 pandemic through direct financial assistance, public guarantees on loans and tax relief, such support are on the verge of expiring. Bank lending to SMEs continues to be a challenge due to the demand for collateral. Banks are also not pairing financial support with advisory services, which is a more effective method of supporting SMEs. Nonfinancial support – such as advice on transformation, capability building and networking opportunities – is equally important.



Shortage of knowledge about ESG. Most SMEs do not have the knowledge of resource to develop effective sustainability plans compared with larger companies in order to decarbonise. While many ESG investments allow companies to realise cost savings, the required upfront investments can hinder SMEs from pursuing these.



Need to go online. As the world digitises, many SMEs are at risk of being left behind. Digital solutions are often designed for large enterprises and are difficult to scale down. SMEs commonly cite that digitalisation is too expensive to adopt.

Most FI boards take their SME customers for granted, insisting that SMEs meet their standards of collateral and lending, rather than recognising that working with them is mutually beneficial. Since SMEs account for the bulk of business and product innovation (even though these are often bought up and taken over by large companies), FI boards can make a major contribution to society by working not just with the SME community, but with financial sector stakeholders – corporates, advisory firms, regulators and the financial community – on setting clear ESG standards for Malaysian companies. They need to lobby the international standard-setters and regulatory bodies to recognise ESG standards that are realistic and fit local conditions and needs.

## What boards should prioritise and how they should do it:

**1** Boards are already aware that they need to be more gender-, generation- and technology oriented. It's no longer about just delivering return on equity. The focus of shareholder value has now shifted to meeting ESG standards, failing which, foreign fund managers may not invest in your company. Current ESG ratings have unclear methodologies. A company could be a huge source of waste and emissions, but still receive a decent credit rating as long as it appears to be managing the polluting activities well. This explains how a cigarette company, Phillip Morris International Inc, can enter the Dow Jones Sustainability Index and how Exxon Mobil Corporation and BP plc can get an average BBB score from MSCI, despite their entire business being involved in fossil fuel extraction and production.

**2** Women representation as well as young people, particularly the technology savvy, will equip boards with a better understanding of how the consumer business is shifting. Mobile-first, user-friendly transactions, the metaverse, virtual reality, AI, blockchain, cyber currency – the young are much more aware of these than board members who are 50 years and above. There is growing evidence that women-led SMEs have been hit harder by the pandemic in terms of closures, sales, profits, liquidity and growth. The Go Digital ASEAN initiative, which started in 2020, will be implemented across 10 member states, training 200,000 MSMEs and youth to help close the digital gap.

# Governance

SDG and ESG goals are aspirations or ideals that cannot be implemented or achieved without the proper governance structures and incentives in place. Hence, the first task of the board is to identify the FIs values and priorities and how to achieve the SDGs with clear projects and programmes. The next step is to implement the governance structures, management, talent and incentives to make the aspiration a deliverable. In other words, it is walking the talk of ESG.

A top-level leader in Singapore made the comment that in implementing ESG, the company must set an example by undertaking its own ESG evaluation, such as the size of its carbon footprint, how seriously staff consider ESG and what ways and options are available to implement ESG goals. Only through self-examination will the board, top management and staff appreciate how difficult, complex and resource-intensive the exercise can be and apply the same in evaluating the quality of ESG endeavours of their clients and customers.

Governance is not just a structure, but also a process. In this sense, the board must establish a governance structure and processes to oversee not just the FIs own ESG efforts, but that of its clients and customers.

Indeed, the fundamental question is whether the FI is serving the real sector and society as a whole or its own interest. A financial sector cannot be healthy if the real sector or society is suffering.

Thus, the first step of the board is to have a governance structure that will, over the next year, quarter by quarter, lead and evaluate the institution's ESG trajectory. This must be led by the chairman of the board, with a small dedicated team to lay down the evaluation, prioritisation and implementation of the programme. The ESG task force is a parallel track to normal operations and, at some future date, both tracks will converge. The task force should comprise of diverse members of staff who could be seconded from core sectors so that this is not seen as just the job of a special team, but drawn from the community of staff members who care about ESG and will become champions of the programme when the time comes.

As a second step, the evaluation of the institution's own carbon footprint will be a good starting point, with the aid of specialist consultants who are now increasingly available. If no such expertise is available, it will be important for the institution to design and implement ways to obtain such data.

At the end of the self-evaluation exercise, the task force will table its findings to the board for discussion on how these could be implemented across the institution, including its impact on operations, such as credit evaluation, customer relations, staff training and public communications.

The third step is to prepare and communicate a clear business plan to key stakeholders and upskill employees to help their organisations achieve these sustainability goals.

# Recommendations

No company on its own can implement and achieve ESG objectives; it must be a whole-of-society goal and task. Therefore, the board should push the company to be active in dialogues with the financial community, the investor community, regulators, policymakers and the media to get everyone to understand the challenges and monumental task ahead to ESG, failing which Malaysia could be left behind or worse, marginalised.

First, the more the FI itself is ahead of the curve in terms of self-evaluation and experience in implementing ESG, the more influence and credibility it will have in persuading the community and other stakeholders that it is serious in both the talk and the walk.

Second, FIs should be prepared to participate in national level task forces to design ESG standards and work with international standard-setters, such as IFRS, and regulators (International Organization of Securities Commissions, Financial Stability Board, Basel Committee on Banking Supervision, etc) to form Malaysia's views on how these standards should be set in order to protect the interests of Malaysia and the EMDEs. If the ESG standards set by IFRS are almost impossible to comply with by EMDEs, then the financial mechanism would fail to achieve ESG goals, creating 'brown' outcomes through greenwashing.

Third, the more Malaysian FIs and other companies integrate sustainability related factors into their decision-making process – in strategy, risk management, finance and capital planning, research and development, operations, supply chains, organisational structure and talent management, pricing, marketing, and investor and government relations – the more impact Malaysia will have in the regional and global push for ESG implementation.

Fourth, the board may consider if and where it should take a leadership position in the industry and its ecosystem of investors, supply chains, customers and regulators. Sometimes, being a champion of a just cause can engender greater trust from its customers, regulators and stakeholders.

Fifth, FIDE FORUM can convene the relevant stakeholders of government, regulators, large multinational corporations, financial institutions and ecologists to accelerate this process of getting the standards right and tailoring it to the individual SME needs. Members of FIDE FORUM should now work on creating a "Creative Global/Local Commons" in which very experienced professionals in finance, accounting and ecological fields can mentor/assist hundreds of thousands of SMEs in Malaysia, particularly the bumiputera to help them transit to the new online SIGS/ESG standards while remaining profitable. The UK established a creative platform, Viridor, that communicates national ESG strategies from top-level government officials down to local communities. Viridor is closing the economic loop by transforming local government and commercial waste into electricity.

SMEs should also try to get ESG certification from a credible international rating agency (for example, Malaysian rating agencies should get into this field as pioneers) in order to remain competitive and to avoid being accused of not being ESG compliant

Sixth, FIDE FORUM's members should work together with the Employee Provident Fund and Islamic financial institutions which are equity based, to assist inclusivity and increase resilience of the bulge bracket SMEs in the following:

**1** Reviews of whether the leverage that these corporations are taking are too high.

**2** Use Islamic finance instruments to deleverage these companies.

**3** Work on better crowdfunding ideas. Ideanomics, a global sustainability company launched an equity crowdfunding platform in 2021 to help investors and advisors gain access to ESG investments. It aims to empower investors and companies by equipping them with research and other relevant information from respectable independent third-party companies on ESG and other related topics.

**4** Work together with Bank Negara on the values-based intermediation (VBI) mechanism which will assist these companies' access to Islamic finance/equity. As ESG and Islamic finance have many intersecting principles, it comes as no surprise that Bank Negara has combined these two concepts. Currently, the Islamic financial industry is integrating VBI principles into its practices and offering value-based solutions that align with SDG and ESG goals. In 2020 alone, a total sum of RM9.2 billion (USD2.2 billion) worth of VBI-aligned financing was channelled by Islamic banks to 235,000 accounts, with over 95% of it catering to green finance.

Seventh, FIDE FORUM should consider cooperating with Bursa Malaysia to try and establish a carbon market in Malaysia, particularly to get a carbon price so that many of the companies that are able to do carbon reduction will be able to access carbon credits as a new source of financing. Bursa is developing a Voluntary Carbon Markets (VCM) as a reference for international carbon credit transactions. Another Domestic Emissions Trading Scheme (DETS) is also in development to catalyse the carbon trading sector within the country. The DETS will be implemented in phases by end-2022. The Malaysian government is developing a single domestic carbon trading platform through cooperation between the Ministry of Environment and Water, the Ministry of Finance and Bursa. Bursa was chosen to head the development of domestic VCM and DETS because of its experience in implementing capital market operations such as equities and bonds.

There are three main factors in implementing the carbon pricing mechanism in Malaysia.

### Carbon Tax

Two approaches to taxing carbon are the fuel approach and the direct emissions approach. The fuel approach imposes a tax on fossil fuels, such as oil, gas, coal and derivative products. The direct emissions approach imposes a carbon tax on GHG emissions at the source which would include entities that produce or physically generate the emissions.

### Emissions Trading System

This is where the carbon price will be determined by the interaction between market supply and demand. There is a fixed cap on the GHG emissions permitted for each business, and low carbon emitters may sell their excess credits to companies that exceed the cap.

### Carbon Border Adjustment Mechanism (CBAM)

Also known as a 'carbon border tax', CBAM imposes a border fee on imports from countries without acceptable carbon pricing policies. The purpose of CBAM is to reduce the incentive to move production abroad to countries with lower carbon compliance standards and a cheaper cost base by equalising the carbon price between domestic and imported goods.

## Conclusion

The objective of implementing ESG into the daily operations of FIs and other corporations in Malaysia is both an opportunity and a formidable task with complex challenges. This paper has laid out the landscape of opportunity, at a time when oil and palm oil prices are at record highs whilst Malaysia's technology exports are booming due to the geopolitical shift of production facilities away from China. A young and mobile population with good infrastructure in a geopolitically neutral zone, Malaysia has tremendous potential to become a thought leader around ESG design and implementation. There are adequate opportunities to experiment with diverse projects and programmes that could lead ESG implementation with its ideas, concepts and lessons applied to many EMDEs.

FI board members should consider ESG as an opportunity rather than a regulatory or compliance burden. The paper has surveyed and laid out different ideas and options that any FI can implement in its own way to make a difference. ESG is an opportunity and challenge for the Malaysian financial sector to reset and create new businesses that would help Malaysia compete more effectively in a VUCA world.

# 03

## Scenario Planning for Business Strategy and Decision Making

by Nizar Idris

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# Strategic planning and scenario planning are seen by many as two separate disciplines.

by Nizar Idris

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**This** article attempts to build a bridge between the two. In a world that is increasingly turbulent, complex and full of disruption, scenario thinking and scenario planning are no longer options for strategic planning, but have become important and essential management tools for businesses and governments.

Here, I explain the concept, principles and its applications. The tools and processes for developing the scenarios, the challenges of culture, individual cognitive and group behaviours which can affect the quality of the scenarios developed and how they are incorporated into business strategy have been omitted.

In addition to stating the principles, practical examples of real cases are given where scenario thinking and planning have been applied, including some in which I have been personally involved with Malaysian companies. This article presents a digest of case studies beneficial in showing the way scenario thinking and planning have been used in different situations by both businesses and governments.

# Leaders Must Think Differently

**In** an increasingly competitive world, performance and survival mean constantly creating value for stakeholders. This is not an easy task. To remain competitive and profitable business organisations must deal with change and uncertainty. They must adapt quickly to changes in technology, unpredictable global and domestic economies and shifting political and socio-economic landscapes. Recently, this has included ESG (Environmental, Social and Governance) requirements and the need to respond to climate change by operating in a more sustainable manner. Following the 2020 Covid-19 pandemic (hereafter termed 'the pandemic') and the war in Ukraine, the disruption in supply chains have sent commodity prices soaring and created new challenges to businesses.

How can organisations survive and thrive in this world of growing complexity and rapid, unpredictable change? What degree of influence do corporate leaders have and what insights do they need to develop? What tools can these leaders use to guide decisions that have far-reaching impact for success, and even survival; something which is far beyond the familiar and knowledgeable conditions of their current daily business?

Decisions that shape the future of an organisation beyond its current activities are the domain of strategy making. Successful organisations have distinguished themselves with the ability to 'paint maps' of the future and have incorporated this into their business strategic planning process to good effect.

They apply scenario thinking and planning in developing their business strategies for the future. Scenario thinking and planning allow business leaders to change the way they think and behave to enable them to identify the driving forces that can challenge and confront their organisations in the future. Successful organisations have used scenario thinking and planning to help them explore strategic questions of future direction and policy design. Unsuccessful organisations on the other hand, ignore change and are stuck in their business-as-usual strategy. They also pay little attention to uncertainties because of their failure to overcome thinking and behavioural flaws at personal and organisational levels.

# What is Scenario Thinking and Planning?

**Scenarios** are stories of alternative futures. They are about bringing the future into the present so that something can be done about it now. By bringing the future forward, organisations will be better prepared to confront potential threats that can cause a negative impact on the organisation and at the same time identify opportunities that can benefit the organisation in the future. It would give management the chance to be more innovative and creative in managing future challenges to the business.

If business leaders want their company to remain relevant and successful, they need to understand today how their company is likely to be challenged when the competitive landscape around them changes. This has been seen in Malaysia and around the world. As a result of the pandemic, the greater use of technology has changed the way people work, buy and sell. Good examples of this can be seen in the retail business and financial industry. There are, however, many questions to which we still do not have answers today. For example, with the entry of digital banks in Malaysia, where will commercial banks be in the future and will their role change? How will retailing and marketing change in the future? Will there be another pandemic and are we prepared for it? Will the training and education in Malaysia prepare people for a different and challenging world of tomorrow and how will that affect the talent pool of business and industry?

How will changes in demography affect the economy, healthcare, the labour force and people's attitude towards lifestyles? What new challenges besides changes in technology will confront business tomorrow? These are some of the questions that organisations must find answers to if they want to survive and remain relevant in the future. We can already see many signs of change and many more will happen in the coming months and years.

Methodology does exist that can help business leaders to visualise the range of possible futures. Each one of these futures, called scenarios, could plausibly emerge depending on how developments that are going on today continue to unfold. There is no guarantee that these scenarios will happen, and, in fact, they are unlikely to be accurate, but accuracy is not the objective. By creating several alternative visions of the future that have a reasonable chance of emerging, organisations are in a better position to prepare themselves for the flexibility they need to face whichever future does, in fact, unfold. This is what scenario planning is all about. It is a productive, creative, and exciting way to develop the groundwork for the organisation's strategic plan.

# Abandon the Business-as-usual Attitude



**Many** business leaders rely on projections that paint a picture of the future of their organisation which is a variation of the way it currently looks. They fall into the trap of adopting a business-as-usual approach. The scenario method allows business leaders to free themselves from being captured by the assumptions on which business-as-usual rests and opens their minds to questions about those assumptions. Instead of one model of the future, scenarios give business leaders a range of alternatives that should provoke them into thinking more effectively about what the future environment could be and the effect it would have on the organisation.

There are many companies that have achieved success and remained household names over long periods by adopting the business-as-usual approach. However, for many companies, this success has been challenged in the longer term by new innovations and new market entrants.

A look at the list of the Fortune Global 500 companies in the last two decades will show the rate and nature of change. Many companies that were in the list a decade ago are no longer there.

Why do these world-class companies, which are staffed by world-class managers, not survive in the changing world? The answer lies in the business-as-usual attitude of businesses as can be seen by the following examples:

**IBM** was for decades the world's leading computer manufacturer and invented the personal computer (PC). However, it failed to exploit the new technology and product. IBM's slowness to adapt enabled other companies to take the lead in PC development, marketing and sales. These new companies saw the need for new business models to sell PCs to a new, non-traditional set of computer users. Lately, IBM has reinvented itself as a global business consultancy and rebuilt its brand image.

**Kodak** failed to see that digital photography could negatively affect their business. They were too confident that people would not abandon their world-class films for something of a seemingly lesser quality like digital photography. They failed to see that improving technology and a change in customer preferences can alter people's choices.

**Xerox** also suffered a similar fate. In the early 1970s it had a 95% share of the global copier market. Canon then entered the market and competed for Xerox's large corporate customers. Why did Xerox not appreciate the threat and respond sooner? Xerox had a strong business idea, but the very strength and invulnerability of this business idea was its undoing. As Xerox was shackled by its own sales force and leasing policy for its big machines, it was unable to offer smaller machines to its customers.

Globally, post offices used to dominate the world with their postal, telegram and parcel services. Then technology came along and correspondence through letters were replaced by emails. Their parcel delivery service was also challenged by new, faster, better, and more efficient parcel delivery companies. Post offices continued to provide the same traditional services to their clients and saw that their business offerings were no longer attractive. Most post offices have reinvented themselves, but the task is challenging.

Recent years have seen changes in the retail business worldwide. Many big department stores in major cities around the world have ceased business or are closing as customer preferences and requirements have changed. These large department stores did not see that online shopping would lead to fewer people going to department stores to purchase their goods, leading to a decline in business. With further changes in demographics and the greater use of technology, more changes will be coming to the high streets of large cities.

# Don't Forecast the Future — Anticipate It —

**For** many years, governments and corporations used forecasting as a tool to plan their future strategy, however, this is not the best way to visualise the future. Forecasting, generally, is an understanding of what might happen in the future based on facts and data that are currently available to the organisation. Forecasting is tested after the event by comparing an outcome with what was predicted. The problem with forecasting is that it is not always accurate and, unfortunately, it works least when it is needed most, including periods of rapid change similar to those being experienced in the world today. The pandemic, the war in Ukraine, the increase in oil and gas prices, the rise in the cost of goods and inflation have caught everyone by surprise. Many corporations did not factor these into their business strategies and several government plans were also affected. Forecasting could not have predicted these changes.

Forecasts are constructed on the assumption that the world in the future will be like today. The weakness of forecasting is that it does not anticipate major shifts in the organisational environment which can cause significant challenges and disruptions. Forecasting uses quantitative inputs to predict what will happen in the future and, as a result, does not factor in the risk and uncertainty of future events. This, however, does not mean that forecasting is not a useful tool for organisations and that it should be abandoned.

It is most useful for short term strategy or where there is little change in the business environment. Forecasting may be useful in organisations where short term trends matter.

One other difference between forecasting and scenario planning is that the former is inside-out thinking whereas scenario planning is outside-in thinking. Forecasting relies on data and experience in the organisation to plan for the world outside and strategic planning is based on those experiences. Many past Malaysian government plans were based on forecasting. An earlier Malaysia Plan was based on a certain price of crude oil and when the price rose substantially above the figure forecasted, the government faced challenges in managing the Plan, as petrol subsidies upset the budgeting and financing of the Plan and consequentially the growth of the economy as outlined in the Plan.

Forecasting examines what is inside the organisation and uses it as a basis for understanding what is happening outside. Scenario planning, on the other hand, is not based on internally generated data or internal experience but on driving forces which are outside the control of the organisation. They are the forces that bring about change or movement in the patterns and trends of events affecting business like politics, the economy, societal issues, technology, the environment, legal developments and matters affecting ethics and governance. All these driving forces are outside the control of the organisation. By looking outside of the organisation, it gives management an enhanced view of what can affect the organisation tomorrow and it allows management to prepare and deal with these in a compelling engaging way. Scenario planning does not try to predict an ironclad picture of how these happenings outside the organisation will turn out.

Instead, it aims to illuminate and explore different ways the future might realistically develop. It is a productive, creative and exciting way to develop the groundwork for the organisation's strategic plan. Scenarios cannot be proved or disproved.

The scenario planning methodology does not claim that they will materialise as such, and scenarios are not intended to be used on that basis. Outside-in thinking can also uncover opportunities which were not within the scope of a normal, traditional management process.

# The Outside-in perspective of Scenario Planning

## The Driving Forces outside the control of management



Figure 1  
Source: Nizar Idris



# Scenario and Strategic Planning

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## The Unknown Unknowns

**One** way of understanding how scenario planning can be useful in strategic planning is to be guided by the following:

There are known knowns. These are things we know. There are also known unknowns. These are things that we know we don't know. But there are also unknown unknowns. These are things we don't know we don't know.

The known knowns are the normal practices in business management. Organisations identify the opportunities and risks which they know and put in place processes and systems to manage them.

The known unknowns are where organisations are aware that there are things which can challenge or make an impact on the business and management is required to take steps to understand them so that these risks can be managed to the organisation's advantage.

Climate change and cybersecurity are good examples. We know that they can happen, but we do not know how they can negatively affect our business. So, we take steps to understand their effects on the business and manage them.

The unknown unknown is where many organisations have been negatively affected. The unknown unknown is where scenario planning can be most useful. Ordinary business management processes cannot help an organisation to identify the unknown unknowns. Scenario planning can help organisations identify the unknown unknowns so that they can be managed appropriately. However, it needs a new way of thinking and the opening of the minds of leaders to think differently. They need to look at the future with 'new lenses'.



This would require leaders to change the way they look at the future by not applying what they have known and experienced before but with a mind that can think and vision many different possibilities of how the future may evolve in ways which could drastically impact their business. The scenario planning process and methodology is a tested and successful way of achieving this. It is not a science but an art.

Scenario planning has been used to enhance perception as it provides a framework for management to understand and evaluate trends and events as they occur, which cannot be provided by the business-as-usual perspective. It forces managers to make explicit their implicit assumptions about the future and to think beyond the confines of conventional wisdom. It helps to identify information, to anticipate how the future will unfold and overcome the pathologies of organisational life by encouraging debate and questioning prevailing world views.

Scenarios provide a structure for thinking aimed at attacking complexity. This is accomplished by allowing managers to deal more openly and explicitly with acknowledged uncertainty and to arrive at a deeper realisation of what is significant versus ephemeral.

Critics of scenario planning always raise the argument that it is impossible to understand the future as it is beyond the capacity of the human mind. They argue that it is impossible to manage the unknown unknowns and that it is impossible to predict when a pandemic will occur or when or why a war may start somewhere in the world. A scenario is not a prophecy, but the scenario planning methodology provides a means of questioning and identifying signs and data that can point to the occurrence of some event. Part of the scenario planning methodology encourages organisations to think of the unthinkable and to constantly ask 'what if?'.  
 Many different scenarios can be developed. Choose three or more plausible scenarios

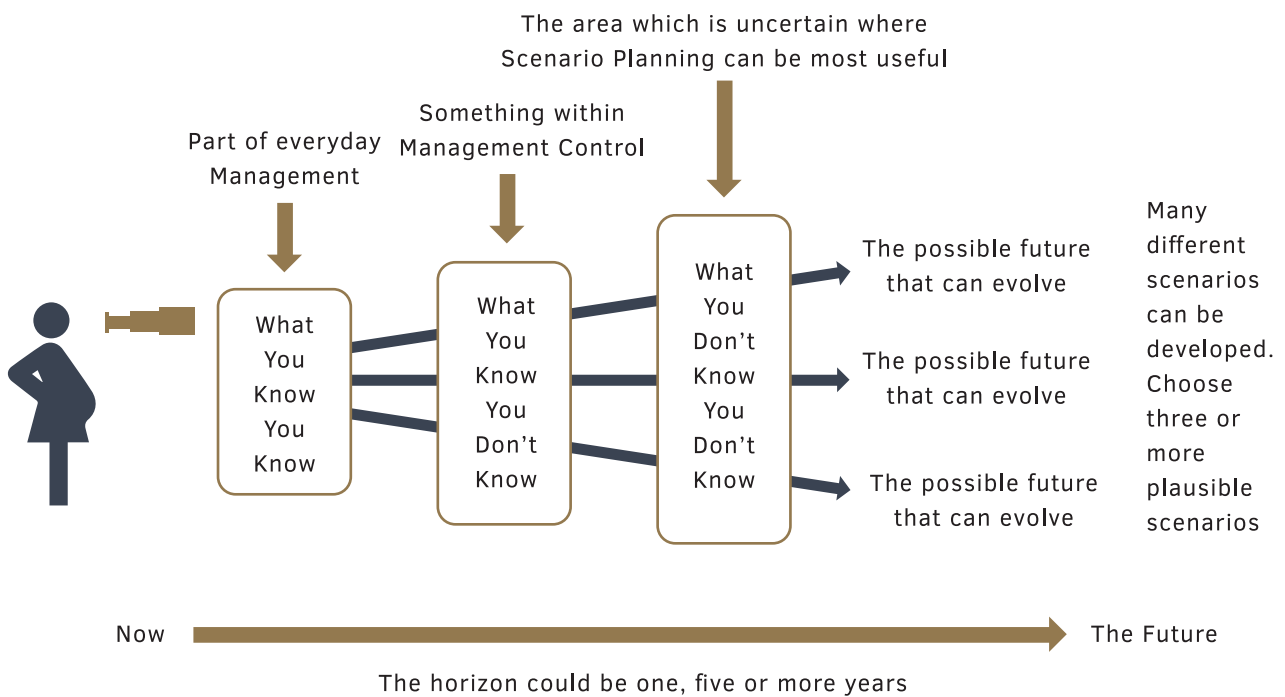


Figure 2  
 Source: Nizar Idris

# Scenarios in the World of Business

**Shell** was the first corporation to use scenario planning as a strategic business tool. For the last 50 years, Shell has been the leader in developing scenarios to understand possible futures and deepen the company's strategic thinking. Shell has developed scenarios on many plausible futures, which have proved to be useful to their business strategy. Their scenarios identified the formation of the Organization of the Petroleum Exporting Countries, the collapse of the Soviet Union and the economic growth of China, and these have been used effectively and successfully in the company's business strategy. The global scenarios were used as a guidance to formulate different business strategies for the Shell companies operating worldwide.

Scenario planning has been used by companies to understand how best to implement a new business initiative. Companies have used it to identify their strengths and weaknesses to position themselves to get into the best competitive position. The UEM Group conducted scenario planning workshops to assist the company to better understand their strengths and weaknesses to manage risks when investing abroad, and to develop a winning strategy for the company when tendering for the Second bridge from Penang to the mainland. TNB also conducted several scenario planning workshops to arm their management with the skills to think differently and to prepare the company in the expansion of their business abroad. Proton also conducted scenario planning workshops to identify the future direction of the company and to examine the prospect of entering new markets abroad.

Gill Ringland in her book *Scenario Planning* gave several examples of how scenario planning has been used by the business world. The Scottish company, United Distillers (now Diageo), used scenario planning to assess the future of markets such as India and South Africa with the aim of finding out how to make whisky more popular in order to expand their business. The Norwegian energy company Statoil identified possible strategies by using scenarios to explore the question "What will be the future patterns of energy consumption?". Caledonian Paper took part in a joint project with IPC Magazine to develop an understanding of the paper/publishing industry. Glaxo used scenarios to explore possible futures for health services and to find a guiding vision for predictive medicine.

When Petroliam Nasional Bhd (Petronas) was incorporated, it conducted several scenario planning workshops to identify where and how it could become a successful global player in the oil and gas business. From my conversation with the those involved in the exercise, I was made to understand that the outcome of those scenarios was the decision to invest outside of Malaysia. Following the scenario planning workshops the downstream division of Petronas also examined the possibility of expanding the business globally. One outcome of this exercise was its involvement in Formula One (F1), which led to improved branding as F1 is associated with quality, precision engineering and world-class performance. Petronas became a Fortune 500 company.

# Scenarios in Decision-making and Driving Organisational Survival and Development

**Complex** decision-making often integrates with strategy validations and testing. Quality decision-making is important. There have been many cases where companies make decisions without understanding the long-term impacts that scenario planning could have identified. Scenario planning helps business leaders become strategically prepared to make better decisions. It brings more structure and process to the decision-making exercise. It helps business leaders consider internal and external factors and provides challenges to existing mental models.

A European medical equipment supplier, conducting business in Malaysia and the surrounding region, conducted scenario planning workshops to determine whether they have a new or larger role to play in the health industry and how to develop this to their advantage. Amongst the alternatives examined was the prospect of expanding the business into medical tourism in Malaysia and the region. Another Malaysian company whose main business was supplying equipment to the water industry in Malaysia and Africa conducted scenario exercises to identify the future direction of the company.

The company discovered that if it wanted to remain successful and profitable in the future, the business needed to be transformed. Internally, the company faced a challenge in convincing people in the organisation that their business model could not be sustained successfully in the long term. People in the organisation believed that as the company was successful there was no need to change it. The challenge was to change the mindset of people in the organisation. The scenarios helped to convince the people to diversify the company's business. The company expanded its business into water management and subsequently it entered the construction business. As a result, it has grown and has become more successful.

CSS Insurance, a leading health insurance company of Switzerland, used scenario planning to update its corporate strategy. The main advantage for CSS of using scenarios compared with their conventional approach to strategy development, was that it enabled them to think through alternative courses of actions in a thorough and consistent way. Anticipating transitions between the various alternatives and the conditions under which this would happen made the outcome more robust, as elucidated by Bill Sharpe and Kees van der Heijden in *Scenarios for Success: Turning Insights in to Action*.

In the same publication, the authors outline how ED&F Man Group plc used scenario planning to help the group anticipate changes in markets. They developed four scenarios, then asked the question, "What are our strengths in each of the four scenarios?".

The answers proved very different for each business of the group. Examining the impact each business would have on the scenarios, the Group decided to divest their sugar products division. Their insurance and stockbroking arms were aligned to the derivatives business.

In a similar exercise a Malaysian company, with business in chemicals and pharmaceuticals, developed scenarios to examine the value contributed by each of its business divisions. Scenario planning workshops were held with members of the management teams and the board. Four plausible scenarios were developed, of which three were chosen for in-depth discussions. Sometime after the workshops, the company decided to separate into two business divisions and the pharmaceutical division formed a separate legal entity.

A Malaysian publication and radio broadcasting company saw the challenges confronting their organisation. They noted that the industry was changing. The newspaper industry was facing stiff competition from social media and their broadcasting business did not have a clear strategic direction of what it wanted to be. There was no clear marketing strategy in the radio business and there was a mismatch of talent. Workshops were held and scenarios of their future business were identified and discussed. Amongst other things, the scenarios developed identified economic, operational and sociopolitical issues confronting the organisation and that the structure of the organisation was too large and outdated. They took action to transform the business.

**Scenarios** have been used by many organisations to obtain clarity or find answers to some puzzling questions or issues confronting the organisation. Scenarios have been used to develop strategies for vocational education and lifelong learning. The European Centre for the Development of Vocational Training developed a method with the aim of helping policymakers to 'think outside the box' of short-term decision-making in order to focus on medium- and longer-term strategy development on the policy and practice of vocational education and training.

## Making Sense of Puzzling Questions

A group of Malaysian small- and medium-sized enterprises wanted to know the future of retailing in Malaysia. They supplied goods to large retail outlets and were heavily dependent on these large retail establishments to promote and sell their products. They wanted to know what forces were at play which could transform the retail business in the future that could affect them. Four scenarios were developed and the forces of change that could have an impact on the retail business were identified.

Besides the use of technology and supply chain issues, one scenario identified a major change in the spending power of Malaysians.

By examining data on demographics and education, the scenarios identified that more girls than boys attend institutions of higher education. These girls would constitute a large percentage of the workforce of the future and therefore a larger proportion of the available money will be in the hands of women. This would have a major impact on the retail business as women would then have larger purchasing power than men. The scenarios identified changes in lifestyle, including the design of products and the colour of cars to suit women as more women would purchase goods and own cars in future.

One outcome of the scenarios is that there would be fewer marriages as women would not be able to find partners who are of the same intellectual standing and capacity as themselves, as has already happened in Singapore. The scenario indicates a decline in population.

In the book, *Scenarios for Success*, Paul de Ruijter wrote an interesting chapter on *Viewing Futures Network: Collaborative Learning and Innovation at Rabobank*. He illustrates how Rabobank, the Dutch Bank, conducted scenario planning exercises with two main objectives. The first was to provide a set of alternative images of the future which would serve as a basis for answering strategic questions. The second was that participating in the scenario process would sensitise the bank's employees towards recognising change as a first step towards building a lasting competitive advantage. Perhaps the most interesting aspect of the scenario planning project extended beyond the bank. The bank invited business relations and partners to discuss the scenarios and meetings were held with independent mortgage intermediaries, construction companies and healthcare development institutions. The process adopted by Rabobank in engaging clients and stakeholders is a standard practice that has been used extensively in scenario planning exercises. Bank Negara Malaysia in their Exposure Draft of December 2021 on *Climate Risk Management and Scenario Analysis* policy also suggest that financial institutions collaborate with their clients and customers when they develop their climate change scenarios.

It is important to note that in the development of scenarios, the process encourages the involvement of different key players, including those outside the organisation who could open the conversations to enable the widest possible exploration of the issues covered in the scenario planning exercise. These people provide insights, which people in the organisation are blinded from by their mindsets being connected with the business for such a long time. The role of these outsiders is to challenge the thinking of the scenario team, including their preconceptions and their preperceptions of any situation. These outsiders can bring insights into futures that are beyond the scenario team's horizon of thought.

**When** Petronas entered the downstream business, Shell in Malaysia saw a major external threat to its business. The entry of a new player into the market itself was not a major concern as competition could produce better quality of service. The big concern was the dual role that Petronas played, as both a regulator of the downstream business and a competitor. Shell in Malaysia undertook several scenario thinking exercises and workshops in order to examine the effects and consequences of that development and how to respond. With the scenarios developed, and following dialogues with industry and the government, the position was subsequently changed when the regulator role was transferred to the government. The scenario exercises had positive results in later years for both Petronas and Shell. There was greater collaboration between the two companies which resulted in joint ventures and the sharing of assets.

Scenario planning has also become an integral part of the Rolls-Royce strategy development process. As Lance Mortlock writes in his book, *Disaster Proof: Scenario Planning for a Post-pandemic Future*, the company realised that it needed a way to prepare for an upcoming disaster after its share price dropped; the result of a decline in demand for wide-body airliners, the movement in oil prices and a slowing Chinese economy at a time when China was a significant customer.

## Developing Specific Questions for Analysis

# Risk Management That Otherwise Might Be Overlooked

**Scenario** planning helps organisations understand external risks by encouraging business leaders to think about those risks and threats more deliberately, thus enabling a better understanding of the impact of those risks on the business. More specifically unfavourable scenarios force organisations to consider any high-impact risks. There have been many instances where external risks are either never fully integrated into the process of scenario planning and scenario thinking or ignored entirely in favour of internal risks.

Practitioners of scenario planning gave an interesting insight on the wrong use of scenarios by the financial industry before the global financial crisis of 2008, as described in the book, *Business Planning for Turbulent Times: New Methods for Applying Scenarios*. According to them, the scenario practices in the financial services sector at the time were deficient. They argued that the model-based quantitative and statistical risk assessment saw the decision criteria of plausibility gradually displaced by a seemingly blind confidence in probability. Many policymakers and risk managers at that time assumed that much, if not all, of the relevant uncertainties could be translated into diversifiable risk and that risk, in turn, could be mathematically priced. The scenarios were used as supports for establishing forms of risk management rather than as aids for embracing the uncertainty in a turbulent time. The scenario work conducted then seriously misconstrued the scenario method. It was argued that the aim of the scenarios was to understand different uncertainties, but the financial services 'scenarios' that were used before the 2008 crisis were used to avoid or prevent risks.



These scenario practitioners believe that this type of misunderstanding will continue to be a serious barrier for the financial services sector to anticipate, mitigate or weather unique events and future surprises. In a scenario planning exercise, managers must embrace uncertainty in order to think creatively yet systematically about possible future events. In doing so, scenario planners focus not on predicting single future outcomes, but rather on managing uncertainty in several scenarios projecting a range of plausible future outcomes.

Scenarios have been used in managing risks and for ensuring the adequacy of capital. Financial institutions apply hypothetical scenarios for what they call stress-testing exercises, which ensures that they have adequate capital and processes that allow them to continue to do business. Financial institutions are expected to run stress tests against defined scenarios. Most stress testing relies on sensitivity analysis, however, this is not usually an appropriate method for dealing with uncertainty in the context of strategy, as it focuses on examining the changes in a single variable while all other variables are held constant. The use of sensitivity analysis may make sense for small changes but, in the real world, things are generally more complex, as can be seen from the economic impact caused by the pandemic which has resulted in lockdowns, disruption in supply chains, closure of production facilities, and the shortage of materials, goods and labour. Clearly, sensitivity analysis considers situations that will never occur in real life, thus limiting its value. Adopting a scenario planning approach brings structure to such complexity, enabling managers to take a broader, systematic view of the business environment, leading to a more sophisticated and useful understanding of environmental uncertainty.

While Risk and Control Self-assessment (RCSA) is a forward-looking component of the operational framework and one of the most engaging tools available to assess risk, there are differences between scenario planning and RCSA. These differences include the time horizon and the magnitude of considered events. Whilst RCSA concentrates on the business cycle and business-as-usual risks (high frequency, low severity), scenario planning focuses on rare but major occurrences (low frequency, high severity). The two tools are complementary in helping to build the overall risk profile. In my opinion, in this turbulent world where there are too many uncertainties, it is to the benefit of organisations to combine them by stretching the time horizon and the risk assessment matrix to a longer period.

# Scenario Planning for Climate Change

**Climate** change and its impact on resource management and societal well-being is one of the greatest challenges facing businesses and their long-term performance. Uncertainty about how access to resources, unanticipated weather events affecting people, rapidly changing market conditions and fast-changing societal reactions to how companies are handling the issue – these risks to organisations make climate change one of the most important risks that have to be managed by all organisations. However, climate-related risks involve large uncertainties and long-time frames that cannot be addressed by conventional strategic planning because climate change issues are dynamic and largely beyond the control of decision-makers in the organisation.

Climate change can affect an organisation in many ways, but three stand out – change in the physical natural environment, change in policy and change in shareholder and/or market sentiment. Change in the physical natural environment can affect assets and infrastructure, suppliers and markets. The second way in which the organisation can be affected is through the development of state or national policies to regulate, reduce and put a price on carbon emissions, driven primarily by ratification of the Kyoto Protocol and at subsequent conferences. The third affect is a result of shareholders becoming activists and using shareholder resolutions, which are voted by all shareholders at annual general meetings, to compel companies to act on climate change through such things as altering their investments and reporting their potential climate change vulnerabilities.

Exxon Mobil Corporation was targeted by shareholder activities demanding the company cut new oil field investments and demanding the use of climate change accounting methods to qualify its climate change risks.

How can businesses respond to these climate change issues and challenges? Normal strategic planning does not provide the solution as these are matters outside the control of the organisation and its management. Scenario planning can help identify what is driving physical, policy, shareholder and other changes that could affect the organisation. Scenario planning can help organisations develop a range of possible scenarios based on the drivers that are identified and translate those scenarios into a climate change strategy that the organisation can use to move forward with confidence.

Scenario planning exercises conducted by one organisation cannot be applied to another in order to manage climate change issues because different organisations face different climate change challenges. Although there is a lot of pressure to embrace the high standard of climate change management adopted in the developed world, scenario planning conducted in the developed world provides no guidance to organisations in the developing world. Climate change issues are sensitive as they affect economic, environmental, and sociopolitical views and opinions. Climate change affects organisations differently depending on the type of industry, the economic conditions, policies of the government in the countries in which they operate and the attitude of society. This means that each organisation must conduct its own scenario planning exercise specifically addressing the climate issues and challenges it faces.



# Scenario Planning and Governments

**Many** governments and their agencies have seen the potential of using scenario planning as a tool to improve the quality of their planning in, amongst other things, policy design, urban development, development planning and education. In 1995, Singapore established the Scenario Planning Office to develop national scenarios and coordinate the translation of those scenarios into policy responses. Today, scenarios are embedded in the Singapore government's strategic planning and budget allocation cycles and, recently, focused scenarios were developed for specific topics like climate change.

The government of Malaysia also saw the benefit of scenario planning. The Advance Leadership and Management Programme for senior civil servants included a session on scenarios for strategic planning and decision-making. Although the civil servants are made aware of the benefits of scenario planning, most projects are handled by the separate ministries and not centrally as in some countries.

Margaret Heffernan in her book, *Uncharted: How to map the Future*, described how the government of Slovenia applied scenario planning to determine the future of the country. The government of Slovenia experienced the paradox of prosperity. The quality of life had improved steadily since World War II with high levels of education and personal security, but Slovenians felt that their quality of life was worse than in the past. The citizens didn't feel they enjoyed equal opportunities when it came to schooling, jobs and housing. An ageing population absorbed a high proportion of resources and although the country was at the forefront of Europe's digital revolution, there was a feeling that the direction of technology was beyond their control. The most profound of all, the citizens did not trust one another. The government wanted to create a new vision and strategy for the country. They conducted a scenario planning exercise.

Perhaps the biggest influence that scenario planning has had on government is the Mont Fleur scenario which influenced the then South African government to abandon apartheid and pave the way for the transformation of South Africa.

## Conclusion

As I have explained above, scenario thinking and planning are no longer an option for strategic planning. They are important and essential management tools for managing the future. Changes can occur and the future may be uncertain but scenario thinking and planning can help us understand and manage them.

# 04

## Strengthening Board Governance Through Diversity

by Tay Kay Luan

Chief Executive of FIDE FORUM

# The challenges of past decades have transformed the way the board works.

by Tay Kay Luan

Chief Executive Officer of FIDE FORUM

**This** has raised board performance expectations when it comes to embracing the necessary compliances and fulfilment of responsibilities demanded by the market it serves. Enabled with the power to steer the direction of business, the board has a primary responsibility to serve the shareholders' interests. The influential position of the board presents an enticing opportunity for improvements to the way it operates and delivers its promises. Diversity is widely seen as an important element of such dynamics. It is regarded as the most significant determinant for corporations to raise their governance standards and increase national-level competitiveness. Within this context this article highlights the ESG opportunities and challenges, specifically board role and contribution of diversity towards addressing the expectations of both market and community. Boardroom diversity, when dovetailed with corporate governance, is in line with both regulators and investors demands for reforms at the highest level of public accountability.

# Concept

**The** term 'diversity' is contextualised today as one of the important factors of the environmental, social and governance (ESG) criteria. ESG credentials are now part of daily boardroom topics. A growing awareness of ESG issues among investors, regulators and consumers means the board must not only take note of such developments, but also demonstrate ESG factors are well understood and integrated within the company's strategy, values and culture. Boosting ESG credentials demands the alignment of board intervention in all aspects of the business. Each of the ESG factors has its own interpretation and meaning. Diversity comes with issues on gender equality across both employment opportunities and rewards. There are communities where diversity issues include ethnicity, age and socio-economic backgrounds.

In recent times, board diversity has gained an important recognition in the governance process. Due to growing regulatory pressure on businesses to resolve the under-representation of women in the boardroom, board gender diversity has gained significant attention over the past decade.

Board diversity has attracted much attention as more institutional and activist investors and regulators put this as a priority in their agenda. A diverse board is considered as one whose members are composed of heterogeneous characteristics in terms of gender, age, experience, ethnicity and professional backgrounds. Diverse boards are regarded as more likely to possess a wide spread of market knowledge, a certain level of technical expertise, right values and behaviours that could make a difference to their capacity to perform and change.

Board diversity is a necessary success factor towards value creation, especially in the planning and decision-making process. The increasing importance of compliance to ensure market legitimacy and to overcome volatility and complexity of market demands has given the push towards the promotion of diversity of skills and experience. Board diversity is therefore seen as part of changing social dynamics as well as a relevant process for value creation and the necessary enhancement of corporate governance. The importance of stakeholder management draws more attention to this process. The trend towards accountability and transparency is to reach out beyond the wider stakeholders. Additionally, board diversity is considered as an important criterion of institutional investments which remains a key determinant in the global economy. All this reinforces the case for how board diversity helps to strengthen governance structure and process.



## The Case for Diversity

**The** emergence of unpredictable and complex issues, often uncharted, has made the case stronger for greater diversity in board composition. It is such context that defines the drivers of diversity in practice and policy among corporations. Given the potential difference this could make to business performance and outcome, corporations have considered this as an opportunity to address and embrace the challenge.

This raises the question of whether regulation should be better placed requiring all companies to fulfil the demand for diversity. Academic scholars refer to a diverse board as one that is made up of an array of directors with distinct but differences in background, including ethnicity, gender and experience. Claiming that one board composition is better than another requires explanation as to whether a diverse board can be more successful than a homogenous one. If so, the question is whether the metrics of success should include only financial indicators on growth and revenue or whether firms be seen in terms of their reputation on gender parity and better ethnic representation.

Board diversity has a role towards improving the organisation's ability to sustain growth built around its principles of responsibility, transparency and accountability. This can be seen in the context of its sustainability strategy that ensures the inclusive element demanded of the diversity and gender element of its ESG. Proponents of board diversity will first and foremost claim that a diverse cast of board members set the stage for a boardroom filled with healthy debates between its members. Distinct backgrounds will shape the thought process of board members and influence the solutions they craft for different scenarios.

The ideal boardroom should look like an arena of ideas where different proposals clash with each other as board members vigorously search for the best option. This process is the key towards eliminating 'groupthink' a phenomenon where an organisation finds itself chained to a single doctrine or thought. Groupthink paralyses critical thinking, causing the organisation to become stagnant, monolithic and prone to crises as it is unable to adapt to different situations. Governance is, at its best, avoiding a dominant one-voice board or one that frequently achieves no consensus. It is important to note that a diverse board brings with it, different skills, knowledge and influence.

Board diversity serves to galvanise the thinking of its members, in theory giving benefits to the organisation in the long run. A board that can come up with solutions to a wide range of dilemmas will help steward the organisation in the right direction, especially in a world characterised by a volatile, uncertain, complex and ambiguous environment. The result would be an organisation that has stable growth and can deliver results on a sustainable basis.

The case for board diversity comes with the basis that having greater diversity helps enhance corporate reputation through its positioning as a non-discriminatory entity in a market that cuts across all ethnicities and values. Global markets are composed of diverse constituencies, indicating a strong case for diversity in board composition. A diverse board brings with it a wider set of knowledge and understanding of unique cultural values and practices.

Increasingly, board diversity has become an investment criterion, as more emphasis is placed on the ethical and moral fabric of business. Social justice as a desired outcome of the diversity journey is being regarded as one of the push factors in the more advanced markets. In the United States, for example, certain groups of ethnic minorities were seen to be marginalised as the nation expanded in both its living standards and corporate wealth.

To this day, income inequality and job opportunities among African Americans, Hispanic Americans and other ethnic minorities are concerns seen from disparity in living standards, wages and career opportunities. This inequality is reflected in the board composition of organisations within the United States. According to Peter Eavis' *New York Times* article, *Board Diversity Increased in 2021. Some Ask What Took So Long*, between the years 2000 and 2021, around 843 companies went public, worth a combined total of US\$10 trillion. Yet of the 4,700 board members of those companies, only 49 are African Americans.

Board diversity is a top-to-bottom approach to solving unequal representation within organisations by introducing a diverse set of leaders to promote inclusivity. The most obvious benefit would be board members with a disenfranchised background providing better grassroots understanding of supportive policies aimed at helping employees and the community. A board member with relevant experience can help improve decision-making processes. For example, female board members may call to investigate hiring practices to ensure that women are not disadvantaged by unconscious bias. The opportunities for improving social justice within the organisation are endless.

# Reputation

**A diverse** board can be seen as a landmark in the fight for equity within the business world as, above all, they are a source of inspiration for the marginalised. Boards are usually the face of an organisation second, perhaps, only to the chief executive officer (CEO). They hold and yield enormous influence. They are symbols of trust; each board member being respected for their experience and capabilities.

Having a board member from a diverse background, be it ethnic, gender or marginalised, is inspiring as it shows that members of that community can aspire to attain a similar standing. In the same way that Satya Nadella, CEO of Microsoft, inspires individuals from the Indian subcontinent and those with Asian backgrounds to try to achieve great heights within the business world, board members from disenfranchised communities could do the same. The board represents the face of corporate governance within an organisation whereby the background and characteristics of the directors are held as representative of what the organisation stands for. The board is, therefore, a crucial driver of the reputation and image of the company that will be closely watched by shareholders, customers and the media alike.

By taking advantage of this opportunity it brings significant benefits in changing the way outsiders perceive the corporation. Board diversity proves to be a powerful tool in this regard. A diverse board projects the image of a progressive and inclusive company whereby significant steps are taken to ensure diversity at the top of the organisation. This makes a positive difference to trust level of how an organisation is being perceived, which has direct impact on the reputation and branding of the company. A diverse composition reflects better the reality of interconnectedness and the diverse global community.

A 2010 study assessing the impact of board diversity on corporate responsibility, *The Impact of Board Diversity and Gender Composition on Corporate Social Responsibility and Firm Reputation*, published in the *Journal of Business Ethics*, demonstrated that gender diversity has a positive relationship. It is highlighted in the study for example, that “women bring several strengths to the board including an increased sensitivity to CSR (corporate social responsibility) and participative decision making”. However, the board must be all-around diverse to ensure each member can voice their opinions instead of being appointed as mere tokens.

Customers would be more inclined to enjoy the services of a company that is headed by individuals with backgrounds like their own. This effect extends to investors where corporations with a diverse board would have leaders that mirror the diverse composition of shareholders as well. Companies that strive to maintain a good public image are also well-received by investors who are more likely to place trust in companies that take real initiatives in the direction of implementing diversity. This is confirmed in research by Joëlle Vanhamme, & Bas Grobbsen titled “*Too Good to be True!*” *The Effectiveness of CSR History in Countering Negative Publicity*, where stakeholders value these strengths as “a long history of good actions should provide leverage for defending the company against challenges to its legitimacy”.

# The Case of Malaysia

**Malaysia**, as an emerging upper middle-income nation has advanced the agenda for board diversity. Although there has been noticeable push by regulators in capital market for greater gender diversity at board level, the increase has been slow. According to a Hong Leong Investment Bank (HLIB) research, the rate of increase has somewhat peaked at 16.6-17.7% between 2019 and 2021. On a positive side, the same report shows there has been an increase in women participation at board level over the past decade. A separate 2021 study by the Institute of Corporate Directors Malaysia (ICDM) and WillisTowersWatson (WTW) covering 312 PLCs on Bursa however showed that boards with 30% women representation mostly in banking, consumer, gloves, media, property, telco and utilities sectors.

A significant trend in the studies further show the number of companies with only male board composition has decreased from 33% in 2016 to 19% in 2020. Although gender disparity remains large, there are clear signs of progress in board diversity as Malaysian organisations step towards more equitable composition in this fast-changing environment. But there are rooms of improvement where the varying challenges demand demand institutional commitment and education.

## Networking

**International** expertise derived from a diversity of skills and knowledge represents useful networking opportunities where members can form connections with influential figures at home and abroad, creating an array of opportunities for the organisation. Experience abroad translates to increased prestige for the organisation as it becomes known for its leaders well-versed in a variety of business climates. A mix of domestic, regional, and global expertise has shown to be key to higher revenue growth, increasing return on equity (ROE) and a higher price-to-earnings (P/E) multiple. In an era of heightening globalisation and interconnectedness, organisations would do well to embrace such opportunity and challenge.

The foundation for an inclusive culture in the boardroom nonetheless requires more effort on the part of the regulators as well as organisations to set an impetus towards opening the path of improving gender diversity on boards. Various exemplary organisations in Malaysia set the standard of diversity, such as those in the Malaysian banking sector. Of the 50 largest listed banks and insurance companies by market capitalisation from 15 Asia-Pacific countries, Malayan Banking Bhd is one of the leading banks in the region for board gender diversity with 36% of its board members comprised of women compared to an average of 17.8% for the 50 banks. The proportion of independent directors in major Malaysian banks who are women is reported as 23.4%, exceeded only by Australian banks. On average the percentage of female independent directors stands at 40% for Commonwealth Bank to 27% at Wespac Bank, according to a report in Money Management in its 8 July 2021 issue. This positive trend has been confirmed by CPA Australia stating that “on the whole, Malaysia’s large financial institutions have been making the right strides in improving corporate governance and risk management practices”. The state of board diversity in Malaysia shows promise, but organisations must continue to develop the infrastructure and take the steps necessary to promote diversity and inclusivity in the boardroom.



# Sustainable Development

**One** of the merits of board diversity is its potential to bring the organisation to a more sustainable future. The *2030 Agenda for Sustainable Development* is a visionary road map for a better sustainable future, to be adopted and upheld by all United Nations (UN) member states. It aims to strike a balance between economic prosperity and social justice. Future emphasis on the challenges include access to healthcare and education, reducing inequality, and sustainable livelihood. All of these would be dependent on a balanced distribution of economic growth whilst ensuring benefits to support the broad goals that are unanimously agreed upon. This vision has in place the 17 Sustainable Development Goals (SDGs) acting as targets to further assist the member states in finding the balance between economic and social objectives.

Of the 17 goals, the most relevant to the mission of board diversity are the SDGs Goal 5 to achieve gender equality and empower all women and girls, and Goal 10 to reduce inequality within and among countries. Gender inequality within organisations is an issue that is often highlighted within the UN, with the *Sustainable Development Goals Report 2021* finding that only 28.2% of managerial positions are occupied by women. Achieving more equitable gender parities is of particular significance to the UN as many developing countries suffer from misogynistic, patriarchal, and anachronistic legal systems that hinder the progress of women in their respective fields, including business. Beyond developing countries Deputy UN Secretary-General Amina J. Mohammed has emphasised that “the average workforce participation rate for women globally sits 20 percentage points lower than the male rate” and that the average gap for advanced economies remains at a 10-percentage-point difference. The UN emphasises the case for more women on boards through the performance gains garnered through increased female representation as it “decreases the level of conflict and increases the quality of board development activities” and highlights data that show companies with a higher share of female board members are associated with higher capital buffers and greater resilience to stress. Practicing what it preaches, the international agencies including the UN agencies have made strides to promote gender diversity. Elsewhere at the International Monetary Fund, female representation has increased over the past 14 years with more senior advisor positions being held by women.

There is significant evidence that such sustainability does matter, a perspective covered in the publication, *Applying Sustainability: Principles and Practices*. Board leadership requires each of them to be fully aware of such global trends, challenges and changes. It is necessary to ensure its decisions on development trends be designed to manage risks or seize new opportunities for sustainability purposes. In coping with the potential social and environmental threats and risks, there is a necessity to possess ESG knowledge and application. One of recent practices includes the appointment of independent directors with such know-how and experience. This is part of ESG actions taken for greener development involving new technologies to harness renewable energy. By being efficient in energy consumption they can account for greater savings and by being responsible, they can enhance the reputation of brands and products.

Board members are expected to pay attention to these increasingly important developments, especially their impacts across the business supply chains, so that efforts are not spared in harnessing and maximising the resources which reduce carbon emission yet add greater competitiveness. One example is in the manufacturing industry. In the past little attention was given to the impact of hiring of workers, whereas today employment conditions can become a trade issue as poor practices can be seen as an infringement of human rights. The impact of construction and operation of buildings on the environment is a further example. Typically, the construction industry consumes large amounts of energy, timber and water resources. But with the high cost of energy required to light and cool buildings, it has made business sense for property management to innovate the application of design methods to reduce energy consumption and deploy renewable energy such as solar, to be more efficient and sustainable.



The commitment to reduce carbon footprint as part of global sustainability targets was well articulated in the Glasgow Climate Pact, an agreement reached at the 2021 United Nations Climate Change Conference (COP26), where promises from governments and businesses towards setting and achieving the reduction in carbon emissions remain positive but there is still some way to go before energy efficiency and conservation efforts yield the necessary results. Achieving sustainable goals is not a bad thing. It offers the board members opportunities to manage the challenges for good reason. A sustainability agenda should be strategic so that organisations can identify how to overcome threats and take advantage of opportunities and changes in a volatile but unpredictable world in order to create a better future. Such opportunities demonstrate the case for diversity of knowledge, views and perspectives.

The objective for inclusivity in the Board agenda is in terms of its contribution towards equal opportunity and participation in socio-economic activities. Among the main targets are to “empower and promote the social, economic, and political inclusion of all, irrespective of age, sex, disability, race, ethnicity, origin, religion or economic or another status”. Supporting this, the UN organisation includes a new dimension in which inequality is perpetuated, that is, through the lens of racial discrimination. Exclusion of individuals of certain ethnicities is not a new phenomenon and the UN has made very visible steps toward the inclusion of those from all nationalities and races within their ranks. Most UN committees and agencies are very heterogeneous in demographic makeup. The role that ethnicity has played in the continuation of economic injustice has been expressed by numerous reputable NGOs, such as the International Council of Psychologists, the United African Congress and the Give Them a Hand Foundation, who have stated that “racism and racial discrimination serve simultaneously both to rationalise the hierarchical domination of one ethnic group over other groups and to maintain psychological, social and material advantages.”

Board diversity can play a massive role in the gradual elimination of gender biases within economies as board members could drive the tone at the top by playing a more activist role within their organisations. These include the removal of unfair hiring practices, pushing for the expansion of hiring networks to include more communities and serving to ensure the welfare of all employees within the organisation including those with a minority background. This would lower the barrier of entry for minorities to engage in economic activities and obtain employment which is critical to tackling poverty in these communities.

The general conclusion that can be made regarding the UN’s stance on board diversity is a diplomatic one, where it is seen as an effective instrument to fulfil the SDGs, namely in promoting gender equality and eliminating inequality. The UN’s endorsement of board diversity is crucial in underlining its importance from a charitable, altruistic angle besides the advantages it gives to performance and earnings. Countries the world over would do well to use the SDGs as a clarion call to act in further cultivating board diversity in organisations within their respective economies.

# Practice

**Board** diversity has been actively promoted by regulators in recent years. Measures currently adopted by different regulatory bodies are generally classified into the following approaches:

I.	Through legislating a minimum quota for female directors on the board; and
II.	by raising awareness on the importance of board diversity and the mandatory reporting of what has been done or planned.

By imposing quotas, regulators refer to mandatory requirements in appointing a minimum number of directors, with preference given to ensuring a more even gender balance at the board composition. Any legislation enactment mainly deals with gender diversity, but this does not compromise the minimum qualifications and standards required. While this will in the long run address the relative underrepresentation of women in the boardroom, the vision continues to focus on the positives of diversity. In some markets, mandatory requirements have already been imposed for gender diversity. While this approach increases the time to achieve the objective there are arguments that this is best left to free market mechanism to ensure balance.

A recent development requires the reporting of corporate responsibility involving the commitment towards enhancement of corporate diversity, including its board composition. Companies, under corporate governance codes, are required to disclose their diversity plans towards the appointment of directors so that investors and stakeholders can make appropriate evaluations. Increasingly, regulators are keen on integrated reporting towards establishing credibility and measurable outcomes. What will make a difference is an alignment of company positions on sustainability performance in their evolving business models.

Over the years, future reporting must emphasise the importance of quality data coupled with analysis and reporting over its performance in managing risks, compliance and addressing stakeholders' inclusiveness, including diversity. The board needs to be fully abreast of evolving transparency through the rising standards of reporting that link management of both tangible and intangible performance with corporate responsibility.

There is debate over whether such enforcement regarding board diversity can be reinforced. There are many who are in favour of regulating such development but there are others who prefer allowing organisations the freedom to ensure a more diverse board. The application of voluntarism is dependent on the assumption that the board of directors, through its own self-governance, takes account of, recognises and accepts its own moral responsibility to building diversity voluntarily and, in these conditions, the willingness to ensure the voluntary sharing of common goals and moral responsibility. In the context of board diversity, it would mean the notion that organisations would implement their policy to promote inclusivity in the boardroom without the intervention of a regulator. Whether this would happen requires an examination of the benefits of board diversity and how it can fulfil the interests of shareholders and the organisation.

The debate on whether firms be allowed the freedom to 'self-regulate' is subject to whether there are incentives to do so and, from cost-benefit analysis, how such development would impact the bottom line. According to McKinsey's *Insights* of July 2021 on diversity, the higher the representation of gender diversity, the higher the likelihood of outperformance. The case for diversity from a financial performance perspective points to the positive correlation between diverse boards and higher revenue, ROE and P/E ratio. The performance advantage delivered encapsulates a wide range of metrics and may be adequately persuasive to galvanize organisations towards adopting a policy of promoting inclusivity in the boardroom. The case for voluntarism is the argument that organisations would be more committed to executing a task if it's out of independent desire rather than being required to comply.

Proponents of regulation would argue that there are too many conflicts of interest, plus hurdles that cause organisations to be in an inertial state of inaction whereby external impetus is required to set board diversity into motion. In its June 2017 issue, *Fortune* published an article on why men still dominate corporate boardrooms. One of the main hurdles quoted was that existing board members prefer to invite their own favourite members into their network.

Furthermore, not all firms can be expected to voluntarily commit to a cause that may not be in line with their practices. One case in point can be seen from corporate reporting activities. An investigation in the oil and gas sector revealed that the American oil giant Exxon had come to understand the impact of burning fossil fuels on climate change as early as 1977. Instead of taking systematic steps toward raising awareness of the issue Exxon actively disseminated climate misinformation, according to Shannon Hall's exposé in the *Scientific American*, *Exxon Knew About Climate Change Almost 40 Years Ago*. Similar cases can be found in tobacco companies covering up the health risks involved with smoking. Doubters of voluntarism usually bring up these examples among others to argue that organisations can't be expected to regulate themselves. Corporate Accountability (CA) believes organisations must be held to task regarding important social issues instead of presenting those issues as 'charity' on the part of the organisation. The non-profit organisation argues that voluntarism would be a flimsy basis for regulation as it isn't legally enforceable and relegates social justice to being optional.

# Regulation

**Moving** beyond the debate between voluntarism and regulation, getting a better picture of how regulation of board diversity would take place is key. Generally, regulators have a role to nurture the growth of inclusivity in the boardroom by requiring minimum levels of diversity, making disclosures regarding diversity mandatory and giving incentives to organisations that do make effective, structural steps towards achieving board diversity. There are examples where companies will be required to explain reasons for their non-compliance in the corporate governance report or equivalent, including a study by ACCA Global on *Diversifying the Board – A Step Towards Better Governance*. In the United Kingdom, for example, the UK Corporate Governance Code issued way back in June 2010 stipulates that companies are required to:

I.	incorporate diversity as a consideration in making board appointments; and
II.	disclose in their annual reports a description of the board's policy on diversity, as well as its progress in achieving the objectives of that policy.

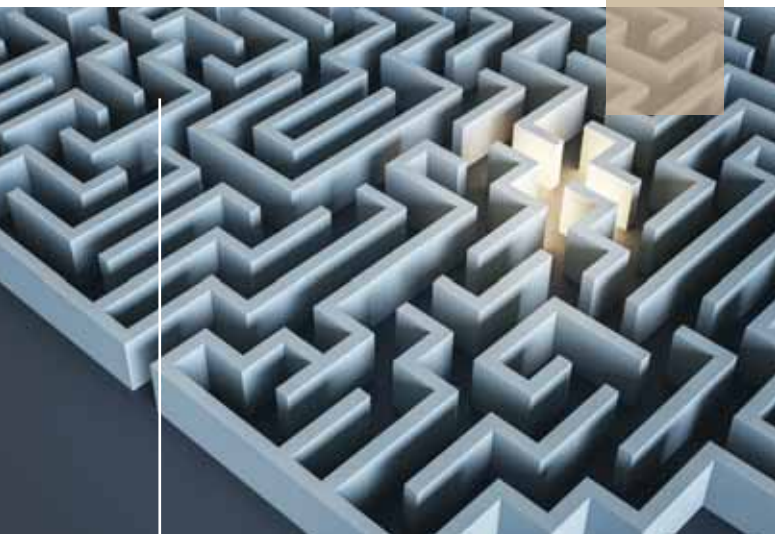
Australia and Hong Kong are promoting diversity using a similar 'comply or explain' approach. Supporters of this approach believe that board appointments should be made based on business needs, skills and ability, instead of legislative requirements, which may sometimes be considered excessive in the market. It's imperative to examine cases of diversity laws being enacted around the world and the degree to which organisations are required to comply. Norway made the earliest move to pass diversity laws by requiring publicly listed companies to have a minimum of 40% of board seats be held by women, beginning in 2003.

This law has shown to be effective, according to a report from the latest 2022, Deloitte Global report on *Women in the Boardroom: A Global Perspective* that shows that Norway spearheads the percentage of board seats held by women in the world at 41%, whilst France, which enacted a similar law, comes in second at 37.2%.

In Illinois (US), publicly owned companies must disclose data on female and minority representation on the board as well as hiring practices to the board. In 2020 Women on Boards, a networked organisation, discovered that states in the US which enacted diversity laws added more female board directors compared to states that did not make a similar move.

Many have voiced how non-compliant organisations can manoeuvre around diversity laws particularly in the US where statutes and mandates are inconsistent across states. Particularly heavy enforcement of diversity laws in one state may incentivise organisations to reincorporate in another state. This would be a reputational disaster as it gives equity markets the perception of the organisation being an unethical one that doesn't comply with the law. Further pressure by investors has followed the proliferation of diversity mandates with the Nasdaq Stock Market submitting a proposal to the Securities and Exchange Commission calling for the creation of diversity requirements. Bank behemoth State Street has stated its intentions to vote against companies without any female directors.

# Challenges



**Board** diversity has grown in both awareness and acceptance among leading organisations across the world. Having illustrated the merits and approaches that can be taken to foster diversity, it would be timely to highlight the hurdles that must be faced to promote the further diversification of boards. Among those hurdles is the existence of exclusive networks borne from university alumnus groups and country clubs that benefit certain segments of society while isolating others. This ‘old boys’ network’ is regularly tapped when boards seek to hire new members, relying on word of mouth and pre-existing ties. This will disadvantage potential candidates who may not be a part of this network, but are by no means less capable.

A recent survey discovered that 85% of searches did not involve an executive search firm, meaning that executives haven’t been making use of wide-ranging networks to find diverse candidates. Board diversity is exceptionally powerful in the scale at which it seeks to foster inclusivity.

Being at the head of an organisation accords it the capability to influence and shape the direction of the organisation. The entry of a diverse range of voices within the boardroom can have its benefits fully realised as marginalised communities gain representation in a body that had been locked to them for the longest time. Board diversity fosters cooperation between those of distinct backgrounds and has shown to be advantageous on an individual, organisational and global level. Opportunities have unequivocally been made in many countries with the barriers of entry to diverse board candidates slowly being broken down. However, as with most issues concerning social justice, board diversity is a goal that cannot be completed at a leisurely pace as the ramifications it has for the rest of society are enormous. Continued action, be it through regulation or voluntarism, on a regional level or through the UN, must be implemented to continue cultivating diverse boards around the world and to break the hold that homogeneity has had on workplace culture for far too long.

Power distance, a measure of the influence seniority accords an individual within an organisation, explains one of the reasons behind the culture of homogeneity which may work against diversity efforts. An organisation with a pre-existing culture of homogeneity is often headed by leaders who aren't familiar with a diverse workplace and are less likely to introduce measures to remedy a lack of diversity. Newer and more junior board members may see the need to include a more inclusive approach, a departure from the more conservative homogeneity rooted within the organisation. Using the Power Distance Index (PDI) as a metric, Malaysia tops the list of countries with the highest PDI in Kate Sweetman's *Harvard Business Review* article, *In Asia, Power Gets in the Way*. The PDI refers to a measurement of the acceptance of a hierarchy of power and wealth by the individuals who make up the general population of a nation, culture, or business. Developed by Dutch social psychologist Geert Hofstede, the PDI ultimately provides insight into the extent to which regular citizens, or subordinates, accept or challenge the authority of the person or people in charge.

There has been a host of seemingly minor disruptions that combine to become a sort of unconscious spectre holding back boards from diversifying. Unconscious bias is chief among them, as many individuals tend to be comfortable with others who are 'similar'. An unwillingness to move beyond one's comfort zone holds back efforts to increase diversity. Besides that, there may simply be a lack of clarity on who is responsible towards addressing the issue on board diversity. As boards operate along the principle of each member being equal it's not always clear who is accountable for promoting diversity. In implementing policies on board diversity, it is expected the chairman and nomination committee will have this added responsibility to ensure the formality of putting in place the proper selection processes. This demands that effective tools deployed, and hiring processes be aligned ensuring maximum transparency in the process. The nomination committee has a duty to push for such development. Hence it is an important part in ensuring diversity of the board and strengthening the governance process.



# Conclusion

**Boards** face challenges, including severe disruption in normal business, which range from market demands to internal resourcing demands. As the worst of the recent pandemic passes, companies will have to be resilient and adapt to the changing business environment. Market demands remain unpredictable. The call for greater board diversity is not new, but it has demonstrated a case that it will play a leading role in creating a more stable corporate governance. A diverse board reduces the pressures of different perspectives and ideas. Insights on recent governance practices reinforce the case for such opportunity rather than risk. Navigating through a society with people of diverse backgrounds becomes necessary and requires experiential attributes like varying education and skill sets, especially in diverse markets.

The alignment of ESG principles is very much in line with principles of board diversity. Boards today have been urged to fully adapt the principles of ESG principles to the evolving business policies. Calls for greater diversity of board composition alerts better organisations to the risk and challenges of doing nothing. Many potential risks will impair business leading to a loss of opportunities to bring about positive change to society. The diverse skills will generate greater opportunity to make a difference, including raising greater awareness towards promoting its commitment to go beyond financial goals. In the final analysis the business case towards accepting the principles of board diversity will prevail and continue to evolve ensuring a higher standard of corporate governance.

# 05

## Web 3.0 and Financial Institutions of the Future

by Olivier Klein

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# Non-fungible tokens (NFTs), metaverse, decentralised finance, cryptocurrency and digital wallets – terms we now hear on a daily basis.

**Are** these just buzzwords or are we talking about legitimate technological advancements? The internet and the World Wide Web (www) have revolutionised how we communicate, trade, innovate and build globally. Online platforms, social media and interactive online platforms have revolutionised how we create. Most people these days experience the internet through a mobile phone for hours in a day and this has driven us to digitise our physical world. Cloud computing has helped tens of thousands of companies worldwide to modernise their business models and platforms. Millions of start-ups are reinventing the world, thanks to scalable cloud services, that drive a rapid pace of innovation and are constantly evolving. Now there is a new kid on the block: Web 3.0. Is this just another buzz word and how does this newly coined umbrella term fit into the space of financial services? Let's dive right into it.

# Web 3.0 and its Driving Force

**As** with everything in technology, there are constant iterations of new ideas, algorithms and ways of operating which drive innovation and provide end users with newer and broader possibilities. With the invention of the original www, we entered an information economy, where everyone with an internet connection is able to access a vast amount of information published on centralised servers from all over the world. These were also the early days of e-commerce with the likes of amazon.com, founded in July 1994.

In this first iteration of the web, later referred to as Web 1.0, one had to have a good understanding of computer systems, access to data centres, servers and the ability to write markup language (such as HTML) to publish content out to the world. Over the years, this iterated towards a Web 2.0 scenario, which is often referred to as the start of the platform economy. Suddenly, platforms such as Facebook, YouTube and even content management systems such as WordPress, made it dramatically easier for anyone to contribute content and publish their opinions. In addition, cloud computing companies, such as Amazon Web Services (AWS), democratised access to the underlying infrastructure to build out your own platform.

It is especially important to note the change of the economic model where, from a situation of expensive capital expenditure for physical infrastructure and hardware, suddenly anyone could get access to the most scalable online services, build out their platform with the latest technologies and only get charged for the actual use of these services; basically, a total operational expenditure model. This allowed many start-ups to set up their business with minimal cost, but be able to scale it quickly based on their success whilst keeping costs sublinear to revenue and growth. In addition, cloud computing has also made sophisticated services in the data analytics space and machine learning accessible to anyone out there. Lastly, Web 2.0 greatly increased the number of internet users by allowing anyone with a smartphone to get access to this platform, some of this access even being mobile-first or mobile-only. Centralising services and data onto one platform can bring tremendous cost benefits, scale and speed. However, moving forward, we are observing a trend of users wanting to have full control of their own data, how it's used, and even be able to monetise it. This even translates into the financial space with fintech companies, which allow non-custodial wallets to exist. This is where Web 3.0 comes in.

Web 3.0 is an umbrella term for newer platforms and services to exist and function on an ever-growing amount of internet nodes and encompasses the following major components:

**1** A more semantic web through the use of artificial intelligence (AI) and machine learning. Instead of looking at raw text or links, Web 3.0 applications are using AI to contextually understand content (specifically in the space of natural language processing and marrying physical and digital spaces in forms such as metaverses).

**3** A token economy where decentralised autonomous organisations (DAOs) initiate distributed networks to provide tokens for value added services and decentralised applications. These tokens are often also referred to as coins (in the context of cryptocurrency) and represent a certain value or worth across a distributed network. This often forms the baseline for decentralised finance (DeFi), but also finds many other applications in the space of gaming (e.g. digital collectibles), or art collections (e.g. NFT), but can also be used for digital representations of actual underlying physical assets (e.g. wine, jewellery, real estate etc.)

**2** Decentralised data architectures where the end users' data is not stored on any single platform or server but, rather, distributed across networks (such as blockchains) and the users themselves are in control of how this data is accessed or even monetised.

**4** Smart contracts. With the ability of a distributed, decentralised network to automatically find consensus in transactions, there is now also the possibility to create smart contracts (roughly speaking, digital contracts written in code) to define business relationships between (un)trusted entities and have them automatically executed on the respective network. This last part fundamentally changes how parties in Web 3.0 operate with each other, as there now can be 'executions' of contracts between untrusted parties, without a central authority or platform.

At the core of this transformation is the concept of a blockchain, which was originally derived from a white paper published after the Global Financial Crisis in 2008, which described what is now known as the first blockchain and cryptocurrency called Bitcoin. The detailed concept of a blockchain is beyond this article, but the most important aspect here is that there is now a way to have decentralised and distributed systems between untrusted parties all over the world transact with each other in a trusted manner. This is done via an immutable distributed ledger often referred to distributed ledger technology (DLT), either on completely public networks (such as with Bitcoin) or on private networks. It is important to note that the aforementioned token economy is built on various different blockchain networks, however the most popular place to create decentralised applications (dApps) or DeFi applications, is through the open-source blockchain project called Ethereum, which comes with an in-built smart contract functionality.

# Blockchain, Tokens, DAO, SSI

## The Core of a Decentralised Web

**As** mentioned earlier, the idea of a 'chain of blocks' first came to light with the publication of Satoshi Nakamoto's white paper titled P2P Money Without Banks, which first implemented as the open-source Bitcoin project. However, it is important to note that nowadays Bitcoin is just one of the many blockchain networks out there and these distributed ledgers truly form the baseline of Web 3.0, far beyond what was initially implemented with Bitcoin. To quickly recap the idea of a blockchain, it allows a distributed network of computer nodes (which can be distributed across the globe) to hold an identical, immutable copy of a ledger of transactions which acts as a single point of reference for everyone in the network. All nodes within this network jointly update and manage this ledger so, roughly speaking, it is a database that contains all transactions, spread in a decentralised manner all over the world. Some of these nodes might live in cloud environments like AWS, others might run on home computers, some even on mobile devices. Without going into too much detail, it allows users to create a universal dataset that everyone can trust even though the actors might not know or trust each other. This is key to the element of democratisation that is happening with Web 3.0 as people or institutions can now interact over the internet without any trusted third party or intermediary like a bank or clearing house.

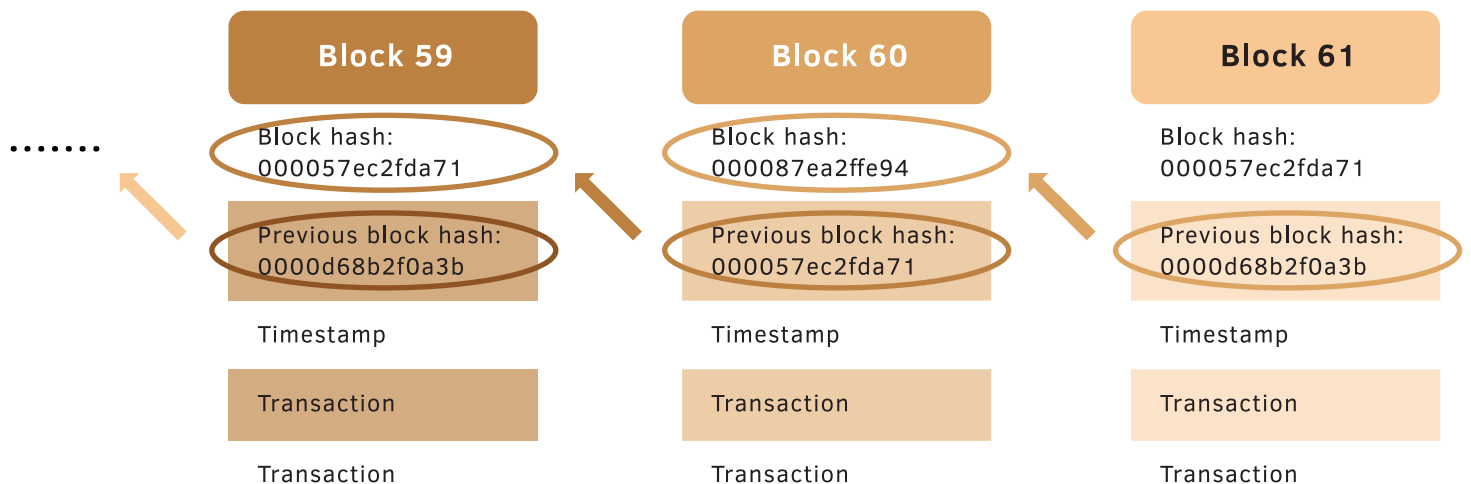


Figure 1  
Source: Olivier Klein

Earlier, we discussed tokens and the token economy. The name might be misleading, as this 'token' is a metaphor; it does not actually represent a digital object, but rather an entry to this globally distributed immutable ledger. Only the person with a private key to this token can access it, often referred to as a 'wallet', which we will describe in more detail. Another interesting component to the blockchain concept is that the entire ledger and its transaction are visible to everyone who is participating in the network. Contrary to the belief that protocols such as Bitcoin are anonymous and non-traceable, a public blockchain fully reveals all transactions, its sender and receivers. There are even websites out there dedicated to exploring transactions on public blockchains, such as Blockchain Explorer. Especially if blockchain addresses are to be linked to central exchanges (such as Kraken, Coinbase, Binance, Crypto.com, etc.), which perform Know Your Customer (KYC) checks, any individual can easily be de-anonymised. There are protocols which are trying to include further privacy into their blockchain (e.g. Monero, ZCash) but for regulated sectors such as the financial services industry (FSI), it's of benefit to have transparency in all these transactions. This also creates the baseline for a lot of dApps as certain use cases need this transparency to achieve their goals.

Talking about achieving certain goals, it's also important to understand the concept of DAOs, which are core to Web 3.0. Instead of a central top-down approach, which is often the case in existing Web 2.0 platforms, with DAOs, the idea is to have a variety of people interacting with each other to create a self-enforcing open-source software protocol. This blockchain protocol or smart contract itself then creates the governance rules of a DAO. As such it allows people all over the world to contribute to a joint mission, which is constantly evolving and being shaped by anyone contributing to it. It's also important to note that once deployed into a network, it cannot be controlled by any single entity and requires the majority consensus from all participants of the organisation. For established larger blockchains such as Bitcoin or Ethereum, majorities aren't easily formed unless they're beneficial to the greater good. One of the, major upgrades currently in progress is the shift in the Ethereum protocol to move from a proof-of-work to a proof-of-stake, sometimes referred to as ETH2. However, for smaller, newer projects, this can at times present a risk, as a majority consensus might be achieved faster. One of the reasons projects often initially publish white papers is to gain support and attention from a large enough group before deploying their blockchain networks. Overall, this concept allows us to create a great builder ecosystem, which has resulted in thousands of new blockchain projects tackling problems across various industries and use cases.

Another major misconception is that a decentralised web means that everything needs to be public. Indeed, early blockchains such as Bitcoin have remained completely public to this day. However, the advent of more dApps and open-source projects such as Ethereum have looked into offering private blockchains. The difference between public and private blockchains is purely based on who is participating in a network. Private blockchains operate between semi-trusted or trusted nodes of organisations which have existing business relationships. This allows the creation of smart contracts and dApps between existing businesses, where some of the relationships are trusted and others are not. In banking, this might be relevant in order to automate things such as settlements and clearing between organisations without intermediary clearing houses. It might include information from outside oracles to understand where physical commodities or assets are located to formulate financial contracts in the form of Smart CFDs (contract for difference), for example. There are companies such as komgo, which digitise trade and commodities finance through a blockchain-based open platform backed by major industry leaders including banks, trading companies, inspection companies or energy companies such as Citibank, BNP Paribas, Shell, ING, Rabobank and Koch. These are changing paper-heavy, manual processes to a one-stop-shop providing speed, security and efficiencies through shared registries, standardised products, automation and tailor-made functionalities, all living on a private blockchain established between these companies.

Earlier, we also mentioned that Web 3.0 allows users to be in more control of how their identity or data is being used online. One good example of such a use case on a blockchain is a self-sovereign identifier (SSI) or sometimes also referred to as decentralised identifier (DID). This grants a user control over one's digital identity without any central institution or intermediary in between.

As part of your Web 3.0 'wallet', one can now manage one's own cryptographically secured, tokenised credentials, which can represent the digital version of one's driver's licence, loyalty card, Covid-19 vaccination certificate or health certificate. With the help of your Web 3.0 wallet, you can provide temporary access to such information and ONLY to the data points of your choice, as nothing can be accessed without your consent. There are examples in the market of how this is being used by companies such as Affinidi and Global Trust to tamper-proof Covid-19 testing and digital health credentials, saving time for airlines and immigration authorities as well as improving reliability of health status verification for travellers.



# The New 'Wallet' in the World of Cryptocurrencies and the Opportunity in DeFi



**When** we talk about cryptocurrencies, we often also speak about 'crypto wallets'. This term can be slightly misleading as crypto wallets technically don't store your crypto and can't hold actual cash. A (blockchain) wallet is a piece of software that stores our private key, public key, blockchain address and communicates with a blockchain network. All 'holdings' (read: your coins or tokens) are stored in the actual blockchain network, which is distributed across nodes throughout the network. The wallet itself only holds the private keys for the owner to 'unlock' those transactions and claim ownership of them and, as such, has ownership of the actual tokens on that blockchain which in effect can be a cryptocurrency value, such as Bitcoin, Ether, or access to an underlying physical or digital asset. If applied into the finance industry, this is a fundamental difference to the traditional banking system, where the bank acts as the central custodian for underlying values (fiat currency, equities, physical assets, etc). This represents both an opportunity for financial services, but also a risk or threat to existing finance business models, which often purely rely on a central custodian service. In the new world of decentralised finance, as the name implies, there is no central custodian required to transact value between participants of a certain blockchain, and with the help of smart contracts, business relationships and their transactions can be completely automated.

So what opportunity is there for existing and well-established financial service institutions?



**Be** the trusted authority to connect 'off the chain' assets to 'on the chain' tokens. For example, similar to traditional commodities trading, existing financial companies can act as a trusted authority to tokenise physical assets or even as custodian. They can issue tokens within their designated blockchain network, which can then be traded across various blockchain networks, used within smart contracts as collateral or even within dApps.



**Provide** existing customers access via more traditional investing means into cryptocurrencies or tokenised blockchains. For example, Fidelity Investments has started to allow the inclusion of Bitcoin into their 401(k) retirement savings accounts. This allows consumers the flexibility to bridge existing financial services with the newer world of decentralised finance, and banks to become the trusted intermediary and provide reliable access to it. This can furthermore help with the existing scaling challenge experienced by some blockchain networks.



**Issuer** of an SSI. Become the trusted authority to validate and authenticate your customer through KYC. SSIs address the difficulty of establishing trust in an interaction and, in order to be trusted, one party in an interaction will present credentials to the other parties, and those relying parties can verify that the credentials come from an issuer that they trust. This is increasingly important in the Web 3.0 paradigm and existing financial service institutions can benefit from their existing client relationships to issue such verified identities. It's also noteworthy that these identities can further be enriched with information that financial institutions would have about the person 'off the chain', such as credit scores, loan values or overall debt. These off-the-chain information are often referred to as oracles. DeFi oracles are third party off-the-chain services which enable smart contracts to access external real-world data, such as real time asset prices. These are also opportunities to monetise via so called 'gas' fees, which are transaction fees on the blockchain.



**Lending** platforms financed by peer-to-peer (P2P) lending by other individuals with FSI companies acting as access platforms. This can create decentralised lending services using smart contracts to create two-sided markets of P2P credit and lending, not just for tokens, stablecoins and fiat currencies, but also non-bankable assets such as commodities, securities, real estate, art, shares of non-listed companies, increasing the overall lending opportunities which will lead to a convergence of financial markets and the real economy.



**Security** tokens, which can provide a new form of representation, distribution and management of existing securities and thus bridge the gap between the blockchain world and existing equity products.

As Henry Ford famously said, “If I had asked people what they wanted, they would have said faster horses.” Disruption generally comes slowly, gradually and then exponentially. This is a fast-evolving space and now is the right time to evaluate options, contribute to the ecosystem and embrace newer technologies. By no means does this mean every project has good intentions in mind, neither does it mean that blockchain is the right strategy for everything - there are clear scenarios where good old centralised ledgers can also be the right fit, but there are plenty of promising dApps or blockchain projects to solve real-world problems. Those who will succeed will be market winners and potentially ‘eat’ traditional financial service companies’ lunch.

Web 3.0 embraces the concept of more decentralisation, however this does not mean in all forms and with every system.

Cloud computing, which could be seen as a more centralised way of running systems, often powers important off-the-chain oracles or even runs on-the-chain nodes and many providers continue to invest into making this space more easily accessible for any builder. For example, AWS has a variety of blockchain-focused services such as Amazon’s managed blockchain service, where you could get started with your own application in private or public blockchain networks with a few clicks of a button.

A growing global population and economy should strive for more financial inclusion and, despite Bitcoin not being the perfect blockchain system (and might not be around for a very long time), it has laid the foundation of a blockchain technology which can redefine, improve and automate financial services. FSI professionals should continue to watch this space and see where they can contribute, help regulate, improve and above all, benefit from it.

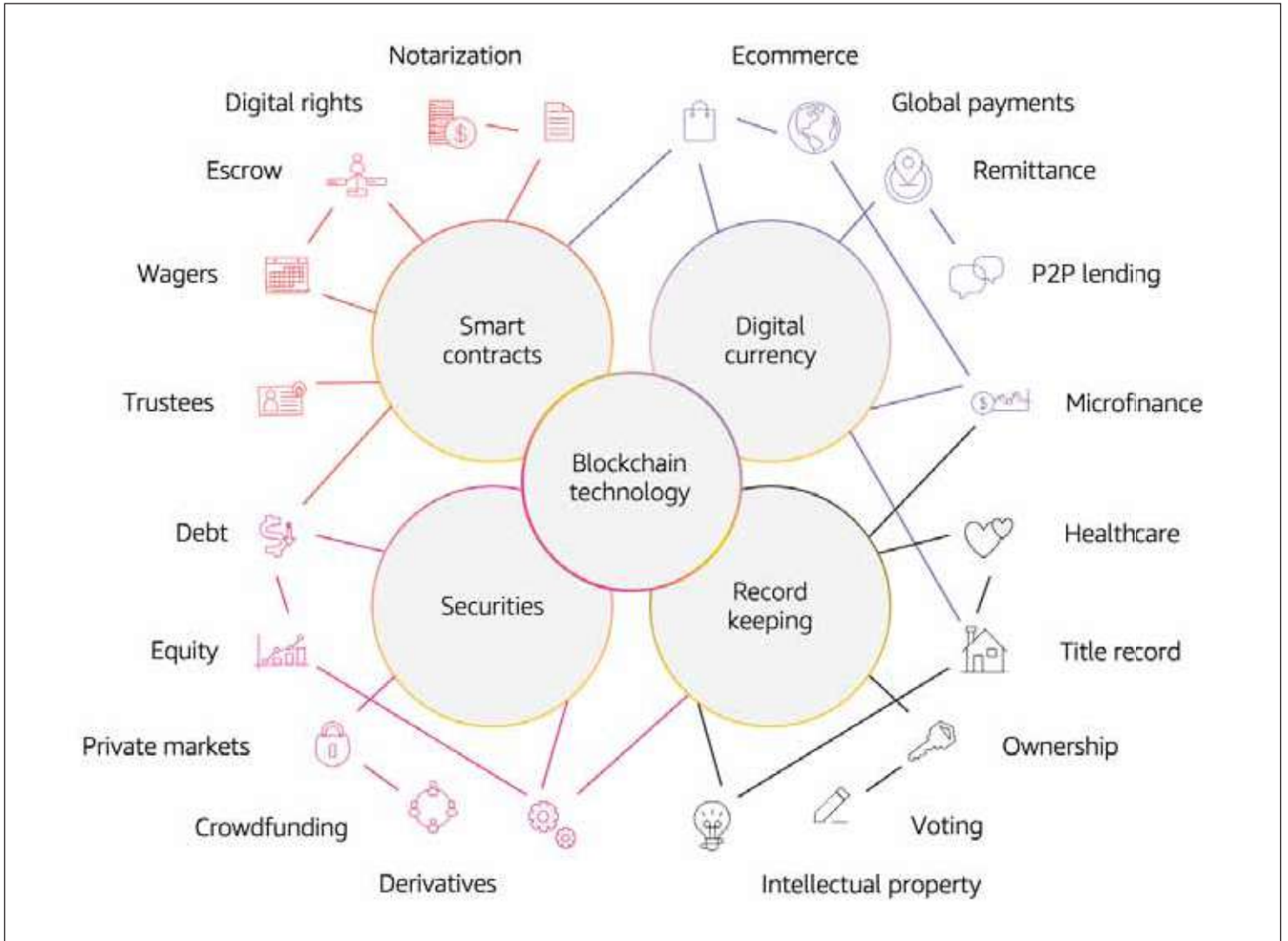


Figure 2  
Source: Olivier Klein



# Operationalising Resolution Planning: A Perspective from the Trenches

by Datuk Yvonne Chia, FCB

Former Group CEO of RHB Banking Group, 1996–2002

Former Group CEO of Hong Leong Banking Group, 2003–2013

Independent Non-Executive Director and Chairman of  
Standard Chartered Bank Malaysia Bhd and  
Standard Chartered Saadiq Bhd (2016–present)

# Bank resolution plans – or ‘living wills’ – are a key aspect of Basel III reforms, and jurisdictions in Asia-Pacific are at different stages of implementation.

by **Datuk Yvonne Chia, FCB**

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**This** paper proffers the perspective that Malaysia’s four-pronged approach to rescue the banking sector during the height of the Asian Financial Crisis – the merger programme, Danaharta, Danamodal, and the Corporate Debt Restructuring Committee – was in fact an operationalisation of what is today known as resolution and recovery of banks. The successful roll-out halted looming systemic failure and formed the building blocks for Malaysia’s current recovery and resolution framework. The experience of RHB Bank Bhd and its mergers with Development and Commercial Bank Bhd, Kwong Yik Bank Bhd and Sime Bank Bhd in the 1990s is used to exemplify and support this perspective. A comparative analysis between the recommended resolution regime post-Global Financial Crisis (GFC) and Malaysia’s four-pronged resolution process during the Asian Financial Crisis is also discussed.

This study contains quantitative and qualitative analyses and reflects both historical data and personal experiences in my capacity as the then Chief Executive Officer of both RHB Bank and Sime Bank.

There are few works that attempt to analyse crises through the lens of opportunity. Here, I wish to share:

- 1 Firstly, how mergers and acquisitions are to be wielded as strategic tools to carve a clear path out of a crisis;
- 2 Secondly, how Malaysia’s four-pronged approach to restore stability in the banking system during the Asian Financial Crisis (AFC) operationalised what is currently known as ‘recovery and resolution’ in banking; and
- 3 Thirdly, how the Malaysian experience during the AFC can be a reflective case study for other jurisdictions that are currently tasked with putting the theories of resolution and recovery into practice.

# Background

**Malaysia's** economic ascendency in the early to mid-1990s came on the heels of consistent economic growth and strong statistics. Tipped by many to become the “fifth Asian Tiger”, the country customised and modelled itself on a set of strategies that worked in the Asian Tiger economies of South Korea, Taiwan, Hong Kong and Singapore, shifting its economic profile from agriculture and commodity dependence to export-driven, low-value industrialisation.

The decade preceding the AFC saw Malaysia's strong and consistent average gross domestic product (GDP) standing at 9.06%; foreign direct investments averaging US\$3.3 billion per annum; as well as topping other global metrics such as its exports-to-GDP ratio, standing at 119% (global average: 68%).

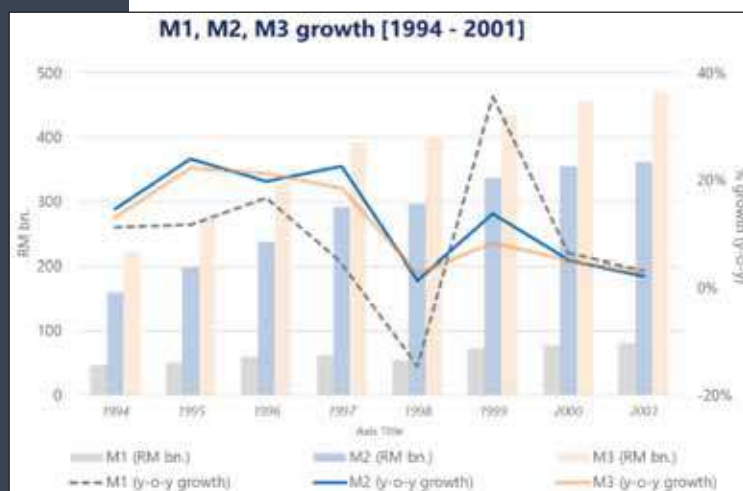


Figure 1  
Sources: PIDM, data from BNM

On other broad economic metrics, the inflation rate for the same period was kept below 4%, the unemployment rate under 5%, with high savings at approximately 40% of gross national product.

Malaysia's money supply showed consistent year-on-year increases (Figure 1) in both narrow and broad money aggregates of M1, M2 and M3. Yet, between 1985 and 1996, the velocity of money (defined as the balance of money supply to nominal income) decreased from 1.6 to 1.0, an indication that instead of holding cash and demand deposits, people had begun diversifying a significant portion of their holdings into higher-liquidity financial instruments such as stocks.

The Malaysian banking system, which in 1996 comprised 89 financial institutions, was highly profitable. Broadly, pre-AFC, banking shares frequently clocked return on equity of around 20% with average return on asset circa 1.2%; it would not be out of the ordinary for the sector's shares to trade at multiples of 18x–20x (blue chips like Maybank surpassed 26x) when the then Kuala Lumpur Stock Exchange average was at 17x. Price-to-book ratios hovered between 3x–5x with margins of 4%–5%. The strength of the ringgit was also reflected in its stable trading between 2.7–2.8 to the US dollar.

In comparison, similar banking stocks at the Tiger economies of Singapore and Hong Kong were only trading at around 18x and 10x respectively.



High loan growth rates (Figure 2) were typical of the early 1990s. Loan growth grew rapidly at 25% and hit its peak in 1996 at 33%, whilst deposit growth was more muted but still impressive at about 22%. Invariably, the banking sector’s overall loan-deposit (LD) ratio, a measure of sustainability for loan growth, stood at a precarious 105%, although some individual banks reportedly kept a higher LD ratio band of 125%–140%.

The configuration of borrower profiles before the AFC (Figure 3) indicates that on average 36% of loans were disbursed to the property sector and for the purchase of securities. This substantiates the view that there was a shift in depositor (or individual) preference towards investment in the booming securities market in Malaysia. The striking investment gains during those heydays were visibly felt and people experienced an elevation in their living standards amidst high rates of private savings. Prudent fiscal policies kept both inflation and unemployment in balance.

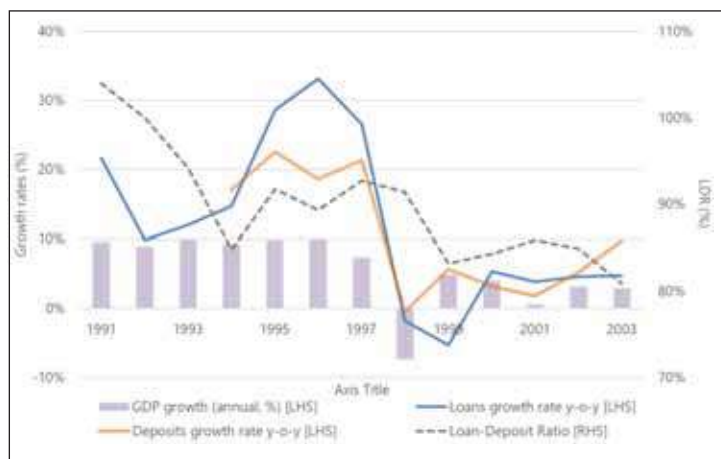


Figure 2

Source: PIDM, data from BNM, CEIC and World Bank



Figure 3

Source: PIDM, data from BNM and CEIC.

The country was en route to becoming another regional economic powerhouse on the heels of strong numbers, moderate inflation and moderate levels of fiscal debt. Despite these strong factors, there were mounting weaknesses in other areas, particularly in the financial sector, where strong capital inflows, extended periods of rapid economic growth, rising property prices and perceptions of implicit government guarantees led in some economies to a degree of complacency by banks in their credit standards.

By early 1996, notwithstanding the strong growth indicators of ASEAN economies, several vulnerabilities began appearing. Signs of overheating in the system were apparent as was the tightening of ringgit liquidity. One interesting indicator of this was securing the funding for a government-guaranteed RM5.1 billion loan to Perwaja Steel Sdn Bhd, a mega-project which formed part of the nation’s industrialisation drive. Closing the syndicated loan took longer than expected as many banks stood on the sidelines with funding concerns.

Against the backdrop of the foreboding challenges at play between 1996 and 1999, unique opportunities emerged for those prescient enough to see such openings in the midst of volatility. In particular, mergers and acquisitions, when timed right and structured tightly to mitigate risk, can be deployed to significant advantage and spell a way out of a crisis.

# Opportunity in Crisis: How Mergers Spell a Way Out

**There** are few works that attempt to analyse crises through the lens of opportunity. The creation of RHB Bank, with its track record of successful mergers and acquisitions, is one of the foremost examples of mergers and acquisitions being wielded as strategic tools to carve a clear path out of a crisis.

In 1991, Tan Sri Rashid Hussain, through his namesake company RHB of which he was executive chairman, acquired a 20% stake in Development and Commercial Bank. This acquisition marked his first foray into banking and a step towards creating a fully integrated financial services powerhouse in Malaysia. For this purpose, Development and Commercial Bank was a fundamentally sound buy – a well-respected corporate and trade finance bank marked by a very low cost–income ratio.

At the time, Tan Sri Rashid Hussain's securities firm was already widely regarded as one of the best in Malaysia and the first brokerage to list on the local bourse in 1988. The opportunity accorded by the Development & Commercial Bank deal catapulted it overnight to becoming Malaysia's third-largest banking company.

With the merger, I joined him in 1994, was appointed deputy CEO in 1995, and assumed the role of CEO in January the subsequent year.



It was necessary to rein in the LD ratio, which at the time stood at an alarming 128%. As the new CEO, this tempering of loan growth bucked the trend of prevailing thought at the time, when banking was a nascent but very profitable sector. This strategy was contentious – the various committees and group management frequently debated what the bank's ideal loan-growth targets should be – as the herd mentality pushed for loan growth and increasing market share was top of mind. However, by December 1995, the bank had brought the LD ratio down to a manageable 87%.

Tan Sri Rashid Hussain's next move was to scale the bank for a dominant position via another acquisition target, Kwong Yik Bank, then a 75% Maybank subsidiary and Malaysia's 12th largest bank. Bearing in mind that there were already signs of overheating, as shared in my interview with The Asiaweek magazine back in 1997, we had already "anticipated and planned for some decline due to the rapid growth in Malaysia" in order to strengthen the Bank's position to weather the impending storm as well as prime itself for an acquisition.

On 1 July 1997, RHB, via its stake in Development and Commercial Bank, acquired Kwong Yik Bank at 2.3x book price. The merger was seen as a best-of-both-worlds deal as it brought together a corporate and retail bank, which when combined was large enough to be a “credible rival for Malaysia’s two biggest banking groups, Malayan Banking Bhd and state-owned Bank Bumiputra Malaysia Bhd”.

The next day, on July 2, when the regional currency meltdown hit, the timely acquisition had solidified the position of RHB Bank as the country’s third-largest bank with combined assets of approximately USD10 billion. Media reports confirmed that the merger had “stabilised earnings, boosted capital and bagged a larger market share among small- and medium-sized industries.” The Kwong Yik Bank acquisition added a further retail dimension, making RHB Bank sufficiently diverse and steady enough to weather the crisis.

According to a BNM report, the merger of Development and Commercial Bank with Kwong Yik Bank still stands as one of only two market-oriented mergers to have been successfully implemented since the mid-1980s.

The next merger deal for RHB was a stiffer challenge as it occurred at the height of the AFC and involved the rescue and recovery of Sime Bank, then majority owned by Sime Darby Bhd.

A brief sojourn into the history of Sime Bank:

As part of its efforts to diversify its revenue source and given the overweight rating of banking stocks at the time, Sime Darby Bhd acquired United Malayan Banking Corp (UMBC), Malaysia’s oldest domestic bank, in December 1995, and subsequently renamed it to Sime Bank. Soon after this takeover, there was market talk of an aggressive push at Sime Bank for loans growth – skewed towards asset-based lending, in particular, properties – ahead of a planned Main Board listing.

Within six months of the AFC, in December 1997, Sime Bank revealed itself to be in a ruinous financial state. Majority shareholder Sime Darby reported a loss of RM1.57 billion for the six months to the end of 1997, whilst the bank saw shareholder funds plunge to RM368 million and a risk weighted capital adequacy ratio (RWCR) of 2.9%, to which BNM announced that the bank needed recapitalisation amounting to RM1.2 billion in order for Sime Bank to meet its minimum RWCR obligation of 8%.

On the back of the successful DCB–Kwong Yik merger, for reasons of exigencies, it was decided by the Board of Directors of Sime Bank and BNM to appoint me as CEO of Sime Bank in addition to my role as CEO of RHB Bank, in which I concurrently led both banks from 1998 to June 1999. This was an exceptional occurrence in the history of Malaysian banking, but unusual times called for unusual measures. The mandate given to me by BNM and the Board of Directors of Sime Bank was unequivocal:

- 1 To avoid a run on the bank.
- 2 To make a return to stable operations.
- 3 To operate as a separate entity, working concertedly with BNM and MoF for a potential sale to bidders.

My foremost duty was to stabilise Sime Bank's operations in order to prepare it for a potential sale. As I was also concurrently the CEO of RHB Bank, it bears mention that there was to be a clear Chinese Wall (a term that's consciously being phased out in order to foster more diversity in financial services, the most recent being the UK Financial Conduct Authority in July 2021) and the preparation of Sime Bank to a stable state was not specifically for RHB Bank. The severity of the crisis meant that when Sime Bank was open to potential bidders, there were no credible bidders as the banks were pressured to save their own operations and not looking to acquire at the height of turmoil. When RHB Bank eventually put in its bid, it was the sole bidder for Sime Bank and the proposal was accepted after intense scrutiny by BNM. Then, in June 1999, BNM approved the proposal by RHB Bank to acquire Sime Bank at RM852.24 million.

Merging Sime Bank with RHB Bank created Malaysia's second-largest commercial bank after Malayan Banking, bringing into the fold over 200 local branches and banking licences in Thailand, Singapore and Brunei. Terms of the acquisition included guarantees from BNM to provide emergency liquidity support and be the lender of last resort. Nonperforming loans in Sime Bank within 12 months of the merger would be sold back to the central bank, and any recoveries would be shared between BNM and RHB Bank on an 80:20 basis.

Although it was not enough to fully offset the dark clouds that had beset the banking sector, these assurances buoyed the sentiments of local and foreign investors, proof that Malaysia had a workable plan of action through this corporate rescue.

Once the mandate was green lighted, the first order of the day was to assemble tight-knit, technically adept teams in three core banking areas – credit, funding and operations. These teams not only needed to be specialists, but they also had to have the ability to see the big picture and be sufficiently diverse in their skill sets in order to connect the dots between the bank's actions and its bearing on systemic risk.

Next, to set our liquidity-first priorities and secure a successful resolution. This entailed mission critical tasks on several fronts:

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**1** Moment-to-moment monitoring and end-of-day review of fund maturities in order to steer clear of a funding mismatch at any point in time. Bear in mind that the internet was not yet at the speed and efficiency that it is today, and obtaining data at the granularity that is commonplace now was impossible back in the late 90s. For the most part it was a manual process, and called for deft talent experienced in gauging sentiment and modelling it in our projections. The bank's daily closing liquidity position was reported directly to BNM as well as the board at Sime Bank.

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**2** Focusing on cooperation and collaboration: other banks for interbank lines; correspondent banks for trade and US Dollar settlement; review of legal obligations to determine committed versus uncommitted lines.

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**3** Retaining critical inside knowledge amongst key staff, especially in credit and loan divisions.

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**4** Communicating the right message to secure buy-in and set a high bar of confidence in the resolution plan amongst staff and the community at large. Prompt restoration of confidence required one to control the narrative. This was especially true in the case of Sime Bank which featured daily in the media as BNM had already announced that it was in the midst of finalising a recovery and resolution framework for the banking system. So, in addition to battling public perception, there was the added task of internal motivation. The sense of urgency and commitment amongst the newly formed teams to protect the years of history within the bank were no less crucial in turning things around.

These measures bore fruit and within three months, Sime Bank returned to stability. There were marked improvements across all financial metrics, sufficient liquidity for a potential bidder to consider the entity as a going concern, and the community was confident of BNM's assurances that their deposits were safe at the bank. The spectre of a failed bank risking a run on the Malaysian financial system receded. In its place were the building blocks for the country's current recovery and resolution planning framework that we see today.

It is appropriate here to note a lesser-known aspect en route to the merger. Prior to the acquisition, ANZ Bank was approached with an opportunity vis-à-vis a management agreement to run Sime Bank for three to six months in order to determine if they wished to take up an equity stake in the bank. Its ties with ANZ Bank went as far back as 1976 through its merchant-banking relationship with UMBC Bank, and ANZ was the natural go-to in a rescue scenario. Upon weighing the risks at hand, the foreign bank subsequently declined the offer. Under such circumstance, RHB Bank was called to step in instead.

The outcome proves two things: firstly, despite the inordinate risk of the merger and looming systemic risk should Sime or another domestic bank fail, we had turned things in our favour and restored confidence in the system; secondly, that the prescience to spot an opportunity in times of tumult is not a trait that comes naturally to all large organisations, but it is a skill that can and should be strategically cultivated in view of future crises.

# Consolidation & Structural Reforms



**The** prolonged currency crisis saw rapid asset quality deterioration at banks. According to BNM's Annual Report 1998, based on the three-month classification policy, the sector's net nonperforming loan (NPL) ratio hit 13.2% by the end of December 1998 from 4.7% the year prior and tightness in liquidity meant that contractionary effects must be countered swiftly and decisively. In this manner, the government's National Economic Recovery Plan, drawn up by the National Economic Action Council, devised a four-pronged approach to strengthen the resilience and stem the looming systemic failure, to which BNM's 1999 publication, *The Central Bank and the Financial System in Malaysia: A Decade of Change* is an excellent compendium to illustrate the concrete steps undertaken during this turbulent time:

- 1 Merger programme for the domestic banking sector.** A pre-emptive strategy that initially covered only finance companies, the merger programme was extended to banking institutions in July 1999. Banks were required to form their own merger groups, subject to minimum shareholders' funds (unimpaired by losses) of the merged banking group of no less than RM2 billion, although banking groups that had already exceeded this threshold were encouraged to participate in order to maintain competitiveness and market share.

**2 Pengurusan Danaharta Nasional Berhad.** The national asset management company was formed to purchase and maximise recovery value of NPLs from banks thereby ensuring that residual NPLs in the system were at manageable levels. Incorporated under the Companies Act on 20 June 1998, Danaharta was subsequently passed by Parliament under its namesake act which came into force on 1 September 1998. The Danaharta Act vested the agency with resolution and recovery powers through the ability to acquire loans and transfer assets without the borrower's consent and to manage the borrowers through the appointment of Special Administrators (SAs).

Mandatory guidelines were set whereby banks with NPL ratios exceeding 10% or those requiring recapitalisation from Danamodal were required to sell all their eligible NPLs to Danaharta. Banks were incentivised to sell their NPLs as the nonearning asset would be replaced with either cash or government-guaranteed zero-coupon Danaharta bonds with yields approximating Malaysian Government Securities of similar tenor. Furthermore, BNM allowed the discount from each loan sale to Danaharta to be written off over a five-year amortised basis.

Transparency was maintained with details of its acquisitions published, including the amount of NPLs acquired and average discounts applied. Notwithstanding the deep discounts, most banks were relieved with the option of selling their NPLs to Danaharta, with RM6.2 billion issued on a discounted basis meaning approximately 40%–60% were to be acquired. The RHB acquisition of Sime Bank reflected Danaharta's profit-sharing arrangement across the board, i.e. any excess in recovery value would be shared on an 80:20 basis between the Bank and Danaharta, however, the financial institutions' share of the upside was limited to the shortfall value plus a holding cost of 8% p.a.

Danaharta also managed the loans of several identified banks to facilitate strategic mergers between the financial institution and acquiring party. Essentially, this was amongst the primary reasons for my appointment as CEO of Sime Bank – to restructure the bank's financials to a state of going concern and prepare it for sale to potential bidders.

**3 Danamodal Nasional Berhad.** A wholly owned subsidiary under BNM, this special purpose vehicle was established on 10 August 1998 and vested with the powers to recapitalise banks. It was funded via RM3 billion in central bank seed capital and the issuance of five-year zero-coupon bonds totalling RM7.7 billion in October, complemented by BNM's decrease in statutory reserve requirement to 4% from 6% previously. A consortium of 57 banks subscribed to a further issuance of five-year bonds with nominal value of RM11 billion at 7.25% discount rate. Although Danamodal's bonds were not government-guaranteed, they carried an implicit government guarantee as a wholly owned vehicle of the central bank.

The 'first-loss principle' was strictly observed whereby existing shareholders must absorb the losses from the sale of eligible NPLs to Danaharta before new capital injection could take place, thus minimising the use of public funds for recapitalisation of the bank. Only viable banking institutions that met commercial terms and market principles were entitled to recapitalisation, after stringent due diligence conducted by international investment bankers.

A minimum of two nominees would be appointed to the bank's Board to institute reforms of sound risk management practices and credit culture, good corporate governance and higher operational efficiencies.

Within two months from Danamodal's commencement of operations, troubled but viable banks were injected with much-needed capital. The system-wide recapitalisation saw average capital adequacy ratio increase to 13% in June 1999 from 9.8% when Danamodal was established. It is also laudable that there was strong support amongst financial sector players and a concerted will to avoid moral hazard at all costs as Danamodal emerged as a substantial holder of several weak banks.

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**4 Corporate Debt Restructuring Committee (CDRC).** Established in August 1998, the debt restructuring agency was tasked with facilitating debt restructuring negotiations for financial institutions and viable borrowers for outstanding loans north of RM50 million. Although it was not vested with legal powers, it played a crucial role in resolving NPL at banks through an informal framework to expedite loan recovery without resorting to legal action.

Most of the cases were victims of either loan mismatches, i.e. short-term funding for long-term projects or dollar-denominated loans whereby their loan servicing amounts shot up as the ringgit plunged to as low as 4.88 per US Dollar. The debt restructuring framework, overseen by a Creditors' Committee formed by creditors who represented at least 75% of the total debt, ensured that creditors' existing collateral rights continued; additional credit extended during the restructuring receives priority; creditors retain the right to exercise commercial judgment; and debt trading allowed on proviso that the buyer does not have a detrimental effect on the restructuring process.

The establishment of this trinity of agencies to restore financial and economic stability in the banking sector required immense interagency coordination, done through a Steering Committee chaired by the BNM Governor.

The speed and mechanism of the recapitalisation plan was impressive. In May 1998, the central bank undertook an intense industry-wide stress test to determine the potential recapitalisation requirements in the event that the regional crisis worsened, which was projected by BNM to be RM16 billion as a worst-case scenario. By August, Danamodal's incorporation set the pounding pace to which Malaysia executed its banking recapitalisation exercise.



These measures improved asset quality as average NPL at recapitalised banks stood at 19.4% in June 1999 compared to 22.5% as at end August. There was no credit crunch for businesses in Malaysia although credit in the banking system contracted by 1.8% in 1998. Most important, by 2001, with BNM's effective resolution framework and support and facilitation of government, Malaysian banks had bounced ahead of their regional peers with their zero-failure record intact and were squarely back on investment analysts' radars.

RHB Bank is a classic case of how all the elements of the government's four-pronged approach – mergers plus the trinity of agencies – were strategically operationalised to carve a path out of the crisis and created a financial powerhouse that was bigger, better and stronger than the individual sum of its parts.

Throughout the tumult, there were rumours that RHB had neither the financial muscle nor leverage to weigh in and see the Sime Bank acquisition through. These rumours were finally put to bed when RHB Bank announced the Sime Bank purchase in June 1999 on a clean book basis, supported by BNM's resolution framework. In total, RHB Bank took up RM1.5 billion worth of bonds from Danamodal in exchange for its sale of RM6 billion in Sime Bank NPLs.

Born out of necessity, RHB Bank can be regarded as the acid test which proved that the series of mergers and acquisitions during the height of turmoil – coupled with the support of government agencies (Danaharta, Danamodal and CDRC) – worked to put out the fire. In this sense, Malaysia had enough evidence as well as experience to upscale the know-how and embed this into the wider financial system.

Subsequently, as Malaysia emerged from the shadow of the AFC, BNM set out broad strategies and a model endgame for the domestic banking sector to mitigate future shocks to the system in its first financial masterplan, which became the archetype for future blueprints.

Specifically, key learnings from the AFC were incorporated into the plan, paving the way for the recovery and resolution structures and processes that we see today.

# The Financial Sector Masterplan 2001–2010

**1 Consolidation:** A ratchet of the merger programme to reduce the number of domestic banking institutions to 10 domestic banking groups comprising 10 commercial banks (as at 2000, 31 including foreign-owned banks), 10 finance companies (previously 19) and 9 merchant banks (previously 12).

**3 Building deep and liquid capital markets:** The absence of a well-developed bond market led to inordinate credit risks being borne primarily by the banking sector. Institutions were thus allowed to broaden their product offering and manage their risk exposures, elements of which are also reflected in the Capital Market Masterplan.

Thus, the Malaysian Insurance Deposit Corporation, also known as Perbadanan Insurans Deposit Malaysia (PIDM) was established in August 2005. An important component of the financial safety net in Malaysia, the deposit insurance system is a fine-tuned model of the blanket government guarantee offered during the AFC. The prescribed limit then was RM60,000 per depositor, per member institution, which the central bank envisaged would mean full coverage for up to 95% of depositors. Together with BNM and MoF, PIDM is vested with powers to undertake the resolution of banks under specific conditions. Funded by annual premiums of member institutions and put Malaysia on par with 95 other countries at the time with existing explicit deposit insurance systems.

Today, the market regards deposit insurance as an embedded cost of banking; however, back in 2005 when PIDM was established in Malaysia, the concept was deemed novel, if not viewed with scepticism by some market players.

On 31 December 2010, the safety net was further strengthened with the introduction of the new PIDM Act 2011 which increased the coverage limit to RM250,000, extended coverage to foreign-denominated deposits, and enhanced PIDM's intervention and resolution powers with broader tools such as designating a bridging institution to temporarily assume commitments of non-viable institutions.

These enhanced measures proved to be fortuitous once the GFC erupted in the US and caused ripples throughout the system.

**Launched** in March 2001, the three-phase plan marked the deepening of measures that restored confidence and stability in the financial system by:

**2 Enhanced risk-adjusted prudential regulation and supervision:** Refining capital adequacy risk weightings based on market developments and risk profile of loan books, a transparent and clearly structured early warning system and a set of prompt corrective measures for weak institutions.

**4 Establishing a deposit insurance fund:** During the AFC, the government's blanket guarantee on deposits and interbank placements created a perception that the prudential authorities would bail out banks at any and all costs. To eliminate this moral hazard, a deposit insurance fund covering small deposits would be established that worked on risk-adjusted premiums to incentivise prudent and performance-based management at banks.

# Deepening Reforms Post 2008

Whilst the 2008 GFC marked a momentous turn in the trajectory of global banking studies, including the Peterson Institute for International Economics' paper on *Why Did Asian Countries Fare Better During the Global Financial Crisis than during the Asian Financial Crisis?* document how Asia experienced relatively short-term impact from the GFC, which originated from the US subprime market failure and disproportionately affected advanced economies.

Although not insulated from the effects of the GFC, the Malaysian economy nonetheless experienced muted impact and a quick turnaround. At the height of the contagion in Asia, the Malaysian economy slid by 6.2% in the first quarter of 2009 (1Q2009), but by 4Q2009 had successfully turned a corner, growing by 4.4%, according to Muhammad bin Ibrahim's 2011, *Impact of the Global Crisis on Malaysia's Financial System* published by the Bank for International Settlements. BNM took precise and decisive action through easing of monetary policy, providing fiscal stimulus, and pre-empting any heightened aversion by banks to continue lending. Consequently, there was no tightness in liquidity, no significant deterioration in credit and confidence in banking institutions remained high. These were signs that the structural reforms and institutional innovations undertaken during the AFC were robust and, in broad measures, had minimised the risk of contagion from the GFC in the Malaysian banking system.

In contrast, advanced economies experienced a painful and protracted crisis, with the spectacular demise of financial giants that were systematically important in global finance – the collapse of Lehman Brothers, the bank run on Northern Rock, the fire-sale of Bear Stearns to JP Morgan Chase for US\$2 per share. Further carnage would have been inflicted if not for bailout programmes like the US government's US\$700 billion Troubled Asset Relief Program to buy mortgage-backed securities and bank stocks, together with multiple rounds of quantitative easing. The unprecedented effects of the GFC on the G20 economies is what led to new thinking and rules to accommodate worst-case scenarios of systematically important financial institutions to be wound down without triggering a meltdown. These recovery and resolution plans (RRPs), also known as 'living wills', were subsequently introduced as part of new measures under Basel III.

An RRP is a contingency plan that is activated in times of severe stress or failure of a bank in order to facilitate either a rescue or a wind-down of operations. It forms part of the resolution framework for jurisdictions to ensure all financial institutions "can be resolved safely, quickly and without destabilising the financial system and exposing taxpayer to the risk of loss" as expressed by the International Monetary Fund's resource *Building a More Resilient Financial Sector: Reforms in the Wake of the Global Crisis*.

Note that Malaysia's financial regulatory and supervisory framework was consolidated with the enactment of the Financial Services Act 2013 and the Islamic Financial Services Act 2013 (the Acts), providing momentum to further align with global standards, including that of the Financial Stability Board (FSB) in respect of recovery and resolution. The Acts repealed the Banking and Financial Institutions Act 1989, Islamic Banking Act 1983, Insurance Act 1996, Payment Systems Act 2003 and Exchange Control Act 1953, thus endowing BNM with enhanced powers to counter stability risks, enhance consumer protection and increase global competitiveness of the country's financial sector.

On 28 July 2021, BNM in collaboration with PIDM established the framework to implement Malaysia's RRP via its Recovery Planning policy document, another milestone in an ever-deepening process to enhance supervision, recoverability and resolvability of banks. The first phase of the roll-out plan is reflected in the latest iteration of the Financial Sector Blueprint 2022–2026 released in January 2022. Banks are expected to submit their initial recovery plans in 2023, which will kick-start the process of resolvability assessments and resolution plans with PIDM. Malaysia's RRP roll-out is guided by the FSB's *Key Attributes of Effective Resolution Regimes for Financial Institutions*, to which the latter was developed post 2008 and set the standard under the Basel process.

It may seem that RRP is a new global requirement for banks. However, when assessed from the viewpoint of history, Malaysia actually operationalised the fundamentals of an RRP during the AFC, well over a decade before the GFC occurred and ahead of global standard-setters. To support this premise, we must refer to two key policy documents that shaped the current RRP landscape:

- 1 Basel Committee on Banking Supervision's (BCBS) *Recommendations for cross-border crises resolutions* published in March 2010; and
- 2 FSB's *Key Attributes*.

The baseline comparison between the post-GFC recommendations and Malaysia's four-pronged resolution process during the AFC reveals an uncanny resemblance:



### Special resolution regimes

Post 2008, BCBS Recommendation 1 outlines the introduction of special resolution regimes (SRRs) and tools aimed at public interest objectives, such as the maintenance of financial stability or the protection of retail depositors. Danaharta, Danamodal and CDRC would today be classified as SRRs due to the nature of their establishment through legislature or as agencies under the government, tasked with protecting public interests throughout the rescue and recovery of domestic banks. Also, the FSB prescribes that resolution authorities must be vested with powers “to exercise the resolution powers with the necessary speed and flexibility, subject to constitutionally protected legal remedies and due process”, which is a mirror of the process in Malaysia whereby the speed and precision at which our three resolution agencies operated allowed banks like RHB Bank and Sime Bank to navigate their way to safety.



### Resolution toolkit

FSB's *Key Attributes*, the international standard for resolution regimes, outlines all the elements that must be in place to prepare for any eventuality, including legal frameworks for vesting resolution powers, collateralisation, funding, cross-border cooperation, resolvability assessments and access to information. During the AFC, despite the lack of global coordination, on a standalone basis and under intense pressure to avoid a systemic crisis, Malaysia not only devised these key elements, but operationalised them. For instance, the merger programme to consolidate the banking system is part of the vested powers of Danaharta, whilst the funding portion was structured in a manner that collaboratively involved Danaharta and Danamodal to minimise use of public funds and avoid a bailout during a time of tight liquidity. In terms of resolvability assessments, these were also undertaken by CDRC on market-driven principles.



## Funding

Privately financed deposit insurance, resolution funds, or funding mechanism must be in place as per Key Attributes guidelines. In Malaysia, although deposit insurance did not exist in 1998, the funding mechanisms via bond issuances, implicit government guarantees and the NPL sell/buy backs were effectively deployed to ensure the rescue did not fall short of financing; any shortfall would have been a further blow as it would undermine confidence in the banking system.



## Safeguards

The Key Attributes respect the hierarchy of claims, in particular that equity should absorb the losses first. Similarly, Danamodal's 'first-loss principle' was strictly observed, whereby existing shareholders must absorb the losses from the sale of eligible NPLs to Danaharta before new capital injection could take place.

The Malaysian banking system underwent significant structural reforms post 1997 and emerged consolidated and stronger in fundamentals. Undoubtedly it was long, arduous and came at significant cost, but taking a long view of history, the painful process of Malaysia's banking reforms during the AFC is akin to ripping off a band-aid – momentary but absolutely necessary for recovery and growth.

These structures, modes and processes became the building blocks for the financial safety net which is firmly entrenched today and reflect Malaysia's lessons in operationalising a system-wide recovery and resolution at a time when this was very much a black box. The measures proved to be beneficial as banking institutions in Malaysia experienced a relatively mild downturn and quick recovery during the GFC. Even with the current Covid-19 pandemic, many worried that the public-health crisis would trigger a financial crisis, but this did not materialise.

# The History of Cycles

**Covid-19** has presented challenges to the financial system, none of which are new. Geopolitical instability, changes in the balance of power, supply chain issues, inflation – these are and will continue to be perennial issues for banks, and can become their Achilles heel if left unresolved.

My experience of using mergers as a path to resolvability indicates that banks fail substantially due to liquidity issues arising from poor asset quality. During such periods of tightness in liquidity, banks should anticipate the signals and the big-picture ecosystem. Thus, part of the science to a fast recovery in times of distress – irrespective of triggers, be it currency, subprime or a pandemic – is to avoid scenarios of tight liquidity.

Banking moves in cycles and from my standpoint, there is nothing too surprising in the circumstances we are faced with today and in the impending future. It is a cycle that will repeat itself and we must learn from the lessons of the past if we are to withstand future shocks to the financial system.

Malaysia's operationalisation of its plan to rescue and resolve banking institutions during the AFC is not a theoretical case study, but one that was forged in fire, and more importantly, was effective in arresting systemic vulnerabilities. It is to the credit of our government and regulators that the mechanisms were then embedded in formal structures and strategic masterplans over the course of a decade. It is also interesting to consider this what-if scenario: had the advanced economies applied our structural reforms from the AFC much earlier, could the collapse of institutions like Lehman Brothers have been averted?

I also believe that there is room to introduce an Asian perspective into the discussion on RRP. The formal structures and processes which Malaysia deepened and fine-tuned in the course of two decades since the currency crisis is a uniquely designed Malaysian antidote that pre-dates the GFC. Although the global recommendations by BCBS, FSB, and other standard-setters emphasise flexibility for each jurisdiction to customise its RRP to national specifications, many countries are still grappling with the practical aspects of a roll-out. Coupled with research indicating that the “traditional bedrocks of global financial and economic stability – that is, the advanced economies – have increasingly become the sources of global instability since the crisis”, it is retrospectively and prospectively worth noting that when caught in the crossfire, Malaysia's banking sector developed resilience and learnt on-the-job resulting in long-term reforms.

Here are three takeaways:

Firstly, the reforms undertaken during the AFC have in many ways shaped Malaysia's resolution framework and made it fit-for-purpose. Secondly, the experience of the 1990s – of being in the trenches – made us agile as we often had to pivot, in consultation with the regulators, in order to pre-empt bank runs and cultivate leadership qualities that inspired confidence in the system. Thirdly, we also considered medium- and long-term implications of our decisions with a view of avoiding a systemic crisis, a practice that was embedded into our psyche even after the AFC had been overcome.

**In conclusion**, Malaysia's experience during the AFC should be considered as a reflective case study, a way of putting the theories of resolution and recovery into practice.







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