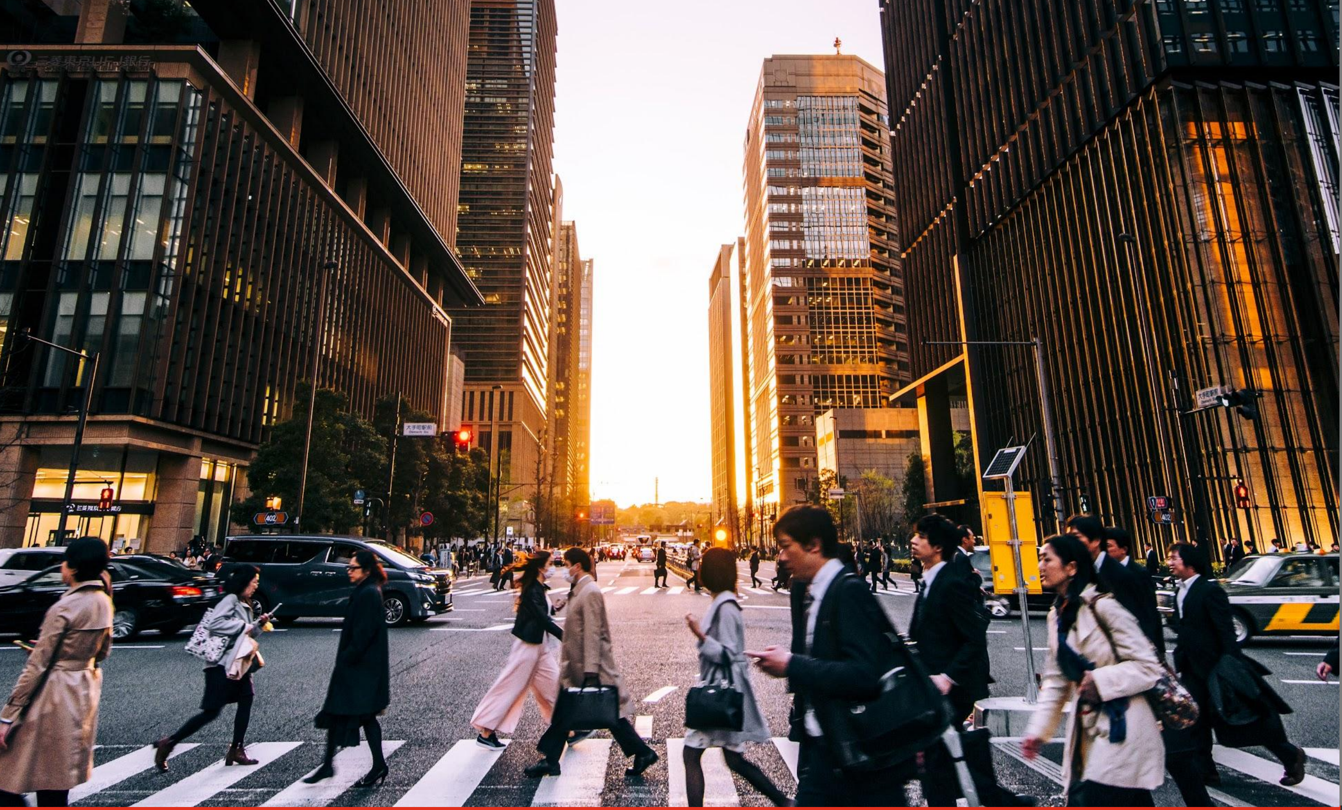

Private banking review: Singapore

Staying ahead in the emerging risks landscape

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I. Introduction

COVID-19 may have set the world upside down, but business leaders know, crises come with tremendous opportunities for competitive reinvention and differentiation. For financial services, like other industries, a strategic rethink today has the potential to catalyse stronger operational resilience and positioning for a new era of growth.

For private banks, even as they continue to report profits, much of it on the back of burgeoning Asian wealth, it's time for enhanced focus on the evolving operational and regulatory risks landscape. Aside from the fundamental shifts in the ways of working and constant changes in the macro-business environment, COVID-19 has heightened regulatory and compliance expectations.

From our review of private banks in Singapore in 2020, we see several gaps across a few thematic risk areas that call for immediate attention. These thematic areas include the perennial topic of anti-money laundering (AML) / countering the financing of terrorism (CFT), the hot topic of sales and advisory, as well as credit and operational risk management.

This publication identifies these gaps, while outlining new risk areas for private banks, set against the backdrop of key developments in the risk and control environment in 2020. We also shine the spotlight on action areas for private banks to stay ahead in the new world.

II. 2020 in retrospect

New working practices

In the face of lockdowns, border closures, and social distancing, banks have adapted to new working practices.

Work-from-home (WFH) arrangements were quickly adopted on a large scale for majority of the staff. At the same time, the need to digitalise business processes was accelerated, and banks switched to various technological tools for enhanced customer engagement.

Coping with new challenges

Some of the key challenges were around workforce planning and mobility solutions, managing disruptions and increased trading volumes, implementing IT capacity controls and cybersecurity measures.

With the re-prioritisation of resources to tackle the new challenges as well as adapting to changes, there have been delays and lapses in execution of some business-as-usual (BAU) controls.

Operational loss incidents

The confluence of significant market volatility and heightened trading activities in part led to increased operational loss incidents in 2020. Across the board, we observed an average year-on-year increase of about 50% in the number of incidents[1]. The dollar amount of operational losses fluctuated, with some banks experiencing two to three times more losses compared to 2019.

As markets remain volatile going into mid-2021, we expect this to continue to be an area to watch out for as general fatigue sets in.

Emerging risks

AML/CFT risks which has always been of focus for the private banks has been made more challenging due to restrictions on face-to-face interactions.

Additionally, the remote working situation has increased operational risk while anecdotally we have also observed greater number of cyber attacks/phishing amidst increased digital acceleration.

Lastly, conduct risk continues to be high on the radar.

[1] Source: PwC research

III. Thematic areas and key observations

From our review of Singapore private banks in 2020, here's a summary of observations on control matters across top four themes:

01

AML/CFT

AML/CFT continues to be an area of focus. In addition, we note that banks can improve on the source of wealth corroboration assessment.

02

Sales and advisory

A hot topic for the year, we have noted multiple findings on pricing controls and disclosures and investment suitability across the board.

03

Credit risk management

Credit risk management was key in 2020, a year of intense market volatility. Banks have been quick to adjust and dealt with the volume, albeit with some delays in periodic reviews.

04

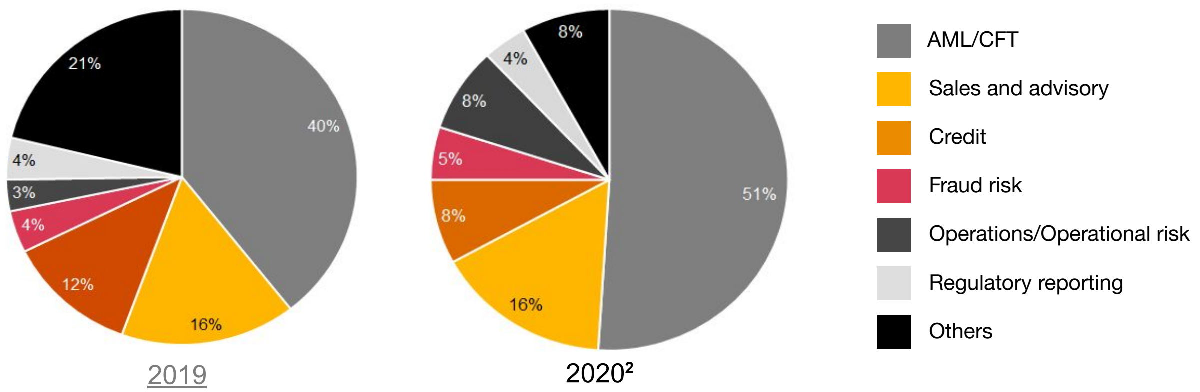
Operations / Operational risk

While lapses in operational controls are not uncommon, we have observed that the timely reporting of operational risk incidents for internal management information (MI) can be improved.

In addition to the top four themes above, we have also noted regulatory reporting errors in prudential ratios computation (Minimum liquid assets (MLR)/ Asset maintenance requirements (AMR)/ MAS 637).

The thematic focus areas for private banks have largely remained similar in 2019 and 2020.

Exhibit 1: Thematic risk areas



[2] Source: PwC research

1. AML/CFT

While we continue to note several areas of improvement in customer due diligence (CDD) and transactions monitoring (TM) processes and controls, we notice delays in timely completion of periodic reviews and clearance of TM alerts. We also focused on the enterprise wide money laundering and terrorism financing (ML/TF) and enterprise wide risk assessment (EWRA).

We noted several gaps across:

A. Enterprise wide risk assessment methodology

- Risk assessment analysis not performed at a granular level for each risk factor
- Inapplicable factors included in assessment of inherent risks
- Lack of documented rationale for the scoring methodology and how the risk scores were determined
- Prior years' internal audit findings not incorporated in the assessment of control effectiveness
- Testing of AML/CFT controls performed by second line of defence not aligned with the controls identified in EWRA
- Lack of mitigating controls identified for areas with higher residual risks

B. Customer due diligence

- **Policy and process:** insufficient guidance in the CDD policy for new client type (VCC), delays in tracking and obtaining pending documents for CDD
- **CDD documentation:** outdated, inaccurate or incomplete CDD documentation, certified true copy not properly performed, inaccurate static data in client onboarding system
- **Customer risk rating:** inaccuracy in initial AML risk rating score determined by front office
- **Name screening:** inaccuracy of names screened; keyword string not used, no date trail, incorrect disposal of screening alerts
- **Source of wealth (SOW):** inadequate corroboration of source of wealth
- **Periodic review**: non-timely completion of periodic review
- **Oversight over activities performed by head office** was insufficient

C. Transactions monitoring

- Untimely evaluation of cases for suspicious transaction report (STR) filing
- Delay in request for approval of extension of timeline for case investigation
- Backlog in clearance of TM alerts
- Lack of proper documentation for clearance
- Inaccuracy of information in STR register

2. Sales and advisory

The Monetary Authority of Singapore (MAS) has carried out inspections across a number of banks in this area, coupled with the publication of the MAS Information Paper "Private Banking Sales and Advisory Practices"[3] in 2020. Many banks have since updated their policies and procedures with respect to pricing and disclosure on client trades. Nonetheless, there still exist a number of gaps where banks have not implemented comprehensive pre-trade or post-trade controls, and/or front office staff have not properly communicated to clients or maintained complete and accurate records of agreed rates.

We noted several gaps across:

A. Investment suitability

- Customer risk profiling
    - Scoring methodology is skewed towards higher risk profiles
    - Lack of audit trail of customer acknowledgement of final risk profile
- Pre-trade checks
    - Lack of disclosure of key product features and risks
    - Inappropriate tagging of solicited/ unsolicited transactions
- Post-trade surveillance
    - Lack of controls to identify trades involving unapproved products
    - Inaccuracy in records of call logs with clients

B. Pricing controls and disclosures

- Standard fees
    - Inaccuracy in set-up of minimum fees in the system
- Bilaterally agreed pricing arrangements
    - Lack of controls over the amendment of client specific fee rates in the system
    - Lack of proper record keeping of special pricing arrangements agreed with clients
    - Lack of system-enforced pre-trade controls to trigger alerts for all product types
- Benefits from price improvements:
    - Lack of controls to review post-trade amendments of price or spread

[3] Source: Monetary Authority of Singapore, Private Banking Sales and Advisory Practices, February 2020

3. Credit risk

We noted gaps around:

- Non-timely completion of periodic credit reviews; lack of documentation of approval for extension
- Lack of approval for exceptional pricing

4. Operations / Operational risk

We noted gaps around:

- Outdated price feeds for the valuation of derivatives
- Lack of formalised process for reconciliation of position breaks
- Lack of timely resolution and escalation of pending breaks
- Non-timely reporting of operational risk incidents

IV. Staying ahead of emerging risks

The private banking industry is expected to see continued broad-based momentum and growth in the coming years in Asia. We urge the private banks do not lose sight of the evolving new risks landscape and take into consideration the heightened regulatory expectations amid the COVID-19 crisis, particularly in the cyber and conduct space.

Actions for private banks to consider across major risk areas

AML/CFT risk

1. Improve robustness of EWRA methodology to provide effective understanding of residual risks banks are exposed to.
2. Monitor and track any backlogs closely.
3. Continuously reassess the effectiveness of interim measures taken to address difficulties.

Conduct risk

1. Ensure sufficient management attention and emphasis on front office conduct.
2. Establish clear accountability and responsibility.
3. Ensure that KPIs adequately consider conduct factors and communicate KPIs clearly.

Operational risk

1. Ensure that incidents are timely, completely and accurately recorded in MI systems used for ops risk monitoring.
2. Enhance business continuity plans to include disruption scenarios from remote working.
3. Stay vigilant in supervising outsourced activities and maintain strong oversight.

Cyber risk

1. Enhance controls against increased risk of data leakage/WFH arrangements.
2. Identify vulnerabilities of critical IT assets and secure its defences.
3. Where new digital tools are implemented, establish appropriate change management and post-implementation reviews.

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