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2014 Banking Industry Outlook
Repositioning for growth
Agility in a re-regulated world

Australia – February 2014

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Foreword

Australia's banks continue to be the envy of the world based on recent financial performance throughout the Global Financial Crisis (GFC). Clearly the financial markets have voted in their favour, given that four of the top 20 global banks by market capitalisation[1] are based in Australia.

This position has given Australia's banks a unique opportunity to focus on the future, while banks in most other geographies have been busy restructuring their organisational strategies, operating models, processes, technologies and balance sheets to comply with regulatory requirements and sound risk management practices.

Nevertheless the volatile, uncertain, complex and ambiguous (VUCA) world will continue to escalate, as the mega trends of an aging population, shifts in prosperity and wealth, globalisation, technology and customer empowerment happen even more quickly, and the innovators continue to disrupt.

To be prepared, the question remains: what investments are required today for tomorrow? Will they be sufficient for a VUCA world? Are they focused in the right areas given the rebound of banks in both the US and Europe? This year's **Financial Systems Inquiry** – the first this century – is seeking submissions to identify the hurdles as well as the dynamics needed to support growth in the economy. It will look at how best to consider the innovations and technologies that are growing both domestic and international competitiveness in the sector.

It will explore the obstacles and any catalysts to funding, focusing again on evaluating essential and appropriate regulation.

As the Inquiry determines its approach and begins its work, it is important to remember that the technologies since the last Inquiry have changed the basic ways products are distributed, tracked and monitored. In addition, real time retail payments and digital currencies are both gathering strength along with the disintermediation by quite disparate non APRA regulated industries including the consumer services related industries.

Delivering clarity in scope of jurisdiction and interagency protocols for regulators such as the prudential regulator (APRA) and the securities commission, (ASIC) will be paramount to avoid both duplication of function and unintentional gaps. There also will need to be a clear focus on how banking regulators interact with the wealth management and insurance industries and their regulators to provide secure futures for the nation.

The recommendations of the Inquiry, if accepted, could drive much of the outlook for banking, and more broadly financial services, over the next decade. And although the implementation of any Inquiry changes are a long way off, the debate on what these changes should be is already underway, and will influence the banking outlook for 2014.

Responding to a limited growth environment

Australia's banks' main priority in 2014 will be to focus on profitable growth in a limited system growth environment while they continue to juggle capital constraints and demands for improved return on equity from shareholders. The hard yards of the last five years of compliance and cost management have resulted in stronger organisations; however operational excellence in both compliance and cost management will not be enough.

Banks must find a way, through tough choices, to drive growth in areas in which they choose to excel; all this in a complex VUCA environment which requires both agility and innovation. To compete effectively in this environment, banks are continuing to review the type of workforce they need, and the influences of their ecosystems, as well as making decisions about what to divest or acquire.

Predictive analytics

The opportunities to pull away from the pack will be defined by how smart and agile Australian banks can be. Fact-based decisions through granular-based data analytics and broader 'big data' strategies offer a real chance for banks to use their relationships to engage customers at the right time and in the right language.

By using scientific insights from multiple data points banks should be better positioned to meet increasing customer demands for advice, home ownership, life stage intervention, wealth management and security in retirement. And as the focus shifts from using analytics for reporting – what happened yesterday – to predicting what might happen tomorrow – banks are reserving the right to get smarter.[2]

Product pool developments – the competitive edge

The realisation that older Australians will likely outlive their savings and have to shoulder a larger share of their own health care costs is causing some banks to explore innovative solutions. These range from 'health savings accounts' – putting aside money now for later health costs, perhaps with the option of sharing risks – to new and different ways for retirees to access capital – 'reverse mortgages on steroids' and deferred lifetime annuities for instance.

As the superannuation pool continues to grow – the asset pool is predicted by Deloitte actuarial research to reach $7.6 trillion by 2033 – financial institutions are considering how best to leverage this investment pool to meet longevity risk. The opportunity for the Financial Systems Inquiry is to explore how the assets in superannuation and home ownership can feed back into the economy to support income and growth, as well as lending and credit lines.

Deloitte forecasts in its Building the Lucky Country Series – Positioning for Prosperity 3b – that trade finance has real opportunities for banks particularly in the potential growth areas of agriculture, as well as gas and mining.

Our positioning for future prosperity is set. Our future will be greatly influenced by the choices made in 2014 by the banks and their customers along with the Inquiry Committee and regulators.

In this Banking Industry Outlook, Deloitte looks at the following six focus areas that banks can leverage to achieve their strategies based on their natural advantages.

These insights are aligned to:

- **Competition and markets** – Evaluating existing industry structure, competitive landscape, or market composition
- **Clients and products** – Exploring emerging trends in retail or institutional customer behaviours, attitudes and needs
- **Governance, risk and compliance** – Reviewing industry risk management practices and regulatory mandates and their potential financial and strategic impacts on industry participants
- **Financial management** – Highlighting how finance leaders can better organise and deliver needed insights to their firms
- **Organisational effectiveness** – Analysing how firms have responded to talent, process and other operational challenges
- **Technology dynamics** – Examining the evolving role of technology in the industry.

We include a graphic element throughout the report to act as a navigational signpost.

We hope you find this report insightful and informative as you consider your company's strategic decisions in the upcoming year.

Please share your feedback or questions with us. We value the opportunity to discuss the ideas in the report directly and workshop them with you and your team.

Rick Porter
Financial Services National Leader
Deloitte Australia

Choosing gears in a VUCA environment

Last year gave good reason for optimism. The ASX 200 index reached new highs. Consumer confidence improved. China introduced comprehensive reforms to revitalise its economy. Low interest rates and increased population growth boosted prices in many residential markets across Australia. The banking industry posted record annual profits and capital levels, and it was able to distribute record dividends to shareholders.

In our 2013 Banking Industry Outlook Deloitte suggested that, 'making hard decisions about where to compete', would be one of the key issues facing banks. Over the last year, many banks globally and a number domestically began to make strategic choices, deciding which of their businesses were 'core', and how to simplify operational infrastructure. As they enter 2014 at different stages in the execution of their operational and strategic positioning, many banks will be able to move ahead, propelled by the strategic choices they have made.

But it isn't all up…

However we all know that since 2007 the world has become increasingly regulated, with significant requirements relating to conduct, capital structure and liquidity. To add to the complexity there is still considerable anxiety as to how the timetable of the agreed regulatory reforms will play out in Australia as the new government begins to revoke some reforms and is considering others.

The hurdles ahead also include near-term global growth remaining subdued. Despite the green shoots in the developed world, it is still only predicted to just surpass 3 per cent in 2015[3]. In Australia, the expectation for real GDP growth is below 3 per cent in the near future[4].

Now that its tapering program is underway, the US Federal Reserve's unwinding of its unconventional monetary policy is contributing to the uncertainty in global capital markets[5]. Rising interest rates could impact banks' capital levels via unrealised losses, and may not provide relief to net interest margin (NIM) pressure until loan demand picks up. Furthermore, interest rate risk, whether repricing risk, or yield curve risk, could pose challenges to some banks, if not properly managed.

Agile leaders and agile teams

To generate the right Return on Equity (ROE in this re-regulated world, it is clear that banks will need to continue to keep a sharp eye on cost management and continue to design more efficient operating models. While these changes are ongoing, the industry knows it must also be proactive in adapting to the new challenges of demanding customers.

As the pace quickens, leaders with the ability to be agile and move an organisation effortlessly and quickly from one product, distribution channel, or operational process to another will clearly be winners.

In order to achieve such performance levels, leaders will need to change how decisions are made and who makes them:

- They will anticipate multiple realistic scenarios, formulating contingent responses to the predictable scenarios
- They will become comfortable with assessing a range of possible outcomes rather than requiring a positive discounted cash-flow based on a single point estimate
- They will regularly re-assess and adapt initiatives as more information becomes available or as markets change.

They will also need to equip themselves with personnel who share tacit knowledge, are comfortable with ambiguity, quickly interpret and dissect needed changes and design enhanced responses and who also have language capability and the interpersonal skills needed to thrive across Australia's and the Asia Pacific's differing business cultures.

The bottom line

Leaders will require across-the-board effort from their teams to:

- Enhance customer experience in new ways
- Leverage the regulatory climate into positives
- Use data insights to deploy capital more efficiently and create value management reporting
- Build agility and innovation for organisational strategic effectiveness
- Link technologies to innovate and optimise performance across multiple dimensions.

In the following articles we consider these topics in more detail.

Finding new ways to differentiate the customer experience

As banks increasingly focus on growth they are using a variety of strategies to grow revenue in a way that optimises the use of capital. These include new fees and thresholds on transaction accounts, re-pricing of premium services, bolstering cross-selling efforts, and a greater focus on fee-based businesses such as wealth management.

Organisations have already begun to put new revenue growth plans to work to better improve cross- sell of wealth management products to their retail, business and corporate customers. However, the success of these strategies will rest heavily on more creative approaches to customer insights and more robust methods in data analytics. The reward is greater cross-sell revenue. The challenges are to get the best insights out of the ever-growing terabytes of data.

Real time intimate campaigning is not there yet – and neither are the policies or procedures. 2014 promises much if businesses focus on leaping forward and using their 'smarts' to anticipate the future. Policies will change – guiding them is important.

What's new for 2014?

Differentiating customer engagement will become a significant revenue generator in 2014.

Social While banks have already embarked on their digital transformational journeys that include mobility, social, big data, cloud and micro targeting, the next step is to combine them to develop a social business model that supports individual passions, builds experience and sustains relationships for the benefit of the customer and the company.

Data and analytics By investing in data and analytics across the banking value chain – from customer on-boarding to complaint resolution – banks can gain unique insights about their customers and products[6]. These investments enable banks to better understand their customers' needs, refine customer segmentation approaches, design more compelling value propositions, and identify effective differentiation strategies, such as service enhancements and other 'next-best' actions. All of these, in turn, will help banks improve their cross- and up-selling and drive revenue growth.

- Part 1 – Getting the insights – most organisations today have enough data to gain insights. They may need to invest in an understanding of which data is important for decisions, who should own the data, how and where it should be stored and governed, along with the technology or people to make it more robust, reliable or timely
- Part 2 – Acting on the insights – to be able to act on the insights and carve up the customers to an individual level is a big job. No-one is there yet.

Competition There are a lot of competitors whose business is data. They set up their systems before they attracted customers and then pulled them in to improve their services and product streams. There are others that intermediate in the payments systems already, taking payments daily in physical locations – not just digital – building up relationships with customers, and building predictive analysis capability. They are now ready to disintermediate portions of the financial services sector value chain, from wealth management and insurance products and services, to non-bank involved transactional lending and payments.

Advice – the new frontier

Customer insights can also help banks design the 'bank of the future', which will provide customers with a superior experience in digital and mobile channels, together with more technology-enabled branch formats and automated outlets largely staffed with advisers to assist customers in making better financial decisions[7].

These contact centres – both physical and virtual – can assist banks use their digital and mobile channels as strategic assets, acting as virtual branches with advisers. They can also help crowd source customer support.

Mindful of the jostling crowd of non-traditional industries gathering to disintermediate banking, whether through payments, advice, transactions, insurance, or wealth management, banks are mobilising organisationally to cross their internal barriers to achieve a more holistic approach to understanding the customer and maintaining customer engagement to take it to the next level.

Customers Customers today have moved from being consumers to 'prosumers' – proactive consumers with significant power to influence. To excel, banks should further engage their consumers in co-designing products. To assist in developing innovations and build authentic, relevant and timely marketing processes, banks and consumers could co-create and design so banks can accelerate their advice capabilities and augment their real time marketing offerings.

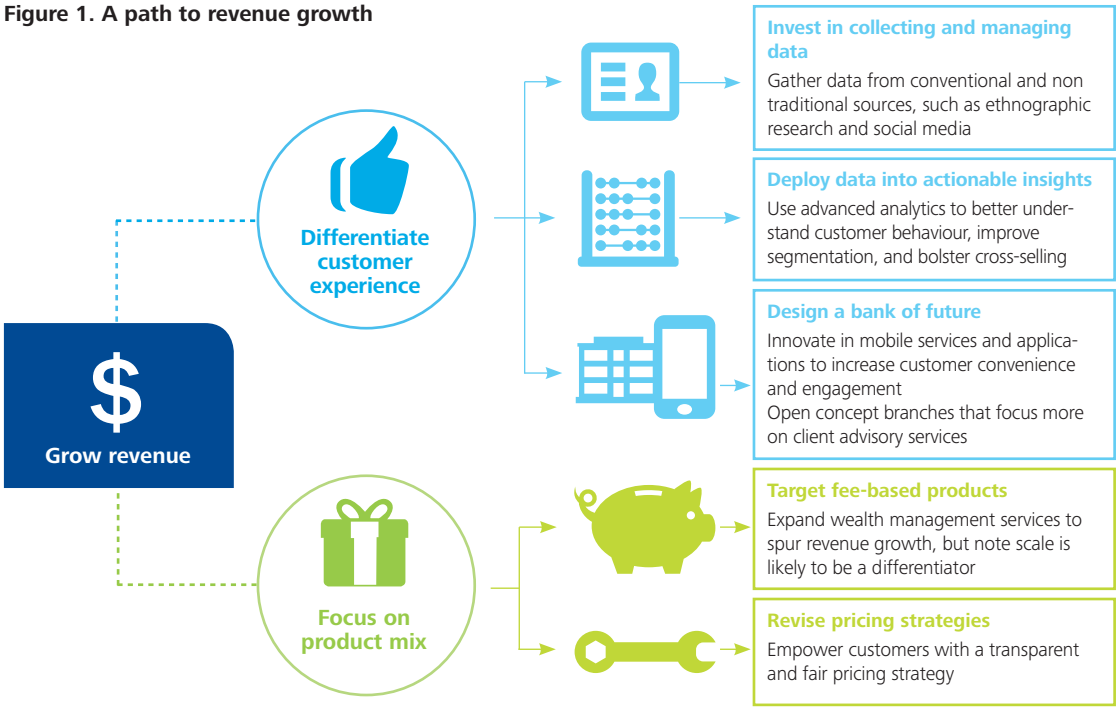
Wealth Management and other services

In tandem many banks will also focus on reshuffling their product mix to generate increased revenue, particularly from fee-based businesses like wealth management. In 2014 competition is likely to intensify, particularly with the FoFA reforms coming on stream, which will potentially hurt profits for some organisations, unless asset growth favours everyone alike.

This could mean scale will become more important again, benefitting large wealth management providers. The implications for the non-banks are that they need to hone their customer service and find ways to develop attractive pricing strategies, not just for wealth management services, but for other banking products as well, especially for business clients. Much consolidation has already taken place, and there is still more to come.

Attempts to re-price existing services will likely continue, but to gain more customer acceptance, all banks will strive for greater transparency, and actively seek ways to place the customers' interests first , providing greater control of 'when' and 'for what' they pay.

Figure 1. A path to revenue growth



Source: Deloitte Center for Financial Services

The bottom line

Delivering high quality, differentiated customer experiences will be critical in driving revenue growth. Putting consumers in greater control of their banking relationship will be likely to make pricing or product changes more palatable. Banks that better leverage advanced analytics to translate big data into valuable insights could be better positioned to meet customer needs and offer a superior customer experience, simultaneously deepening their product relationships with better cross-selling. Banks should take the customer engagement to the next level and have their consumers as co-designers in product development, innovation and marketing.

Leveraging regulatory pressure to 'get to strong'

In 2013 APRA further advanced its regulatory reform agenda in various areas, including capital, liquidity, risk management and the supervision of conglomerate groups.

D-SIBs In December, APRA published its information paper on the Australian D-SIB (domestic systemically important banks) framework and higher loss absorbency capital requirement (referred to as 'HLA'). D-SIBs will not be able to reduce their Level 3 Prudential Capital Requirement through operational separation of their non APRA regulated entities (i.e. no capital benefit is obtained as a result of the diversification of the group activities) and the HLA requirement will be one percent, to be met in full by Common Equity Tier 1 Capital. APRA expects that these requirements will be met by January 2016 on the basis that D-SIBs already have sufficient common equity to meet the requirement.

Mutual ADIs As mutual ADIs cannot comply with the stricter Basel III eligibility criteria for non-common equity regulatory capital, consultation with the mutual sector is also underway. Some mid-tier and mutual banks have also noted that the higher capital requirements, arising because they are not eligible to use advanced accreditation models, should be reconsidered as part of the current financial system inquiry.

Liquidity APRA issued its final position on the implementation of the main elements of the Basel III liquidity reforms for ADIs on 20 December 2013 (APS 210),which include the liquidity coverage ratio (LCR) requiring ADIs to hold sufficient high-quality liquid assets (HQLA). Due to the relative short supply of the Australian Dollar HLQA, the Reserve Bank of Australia (RBA) will allow ADIs (subject to the LCR requirement) to establish a secured committed liquidity facility (CLF) sufficient in size to cover any shortfall between the ADI's holdings of HQLA and the requirement to hold such assets under APS 210. ADIs are required to demonstrate that they have taken 'all reasonable steps' towards meeting their LCR requirements through their own balance sheet management, before relying on the CLF. The results of the 2013 trial exercise (published by APRA in January 2014) indicate that some ADIs may have a lot more work to do to satisfy APRA that they are appropriately managing their liquidity risk. ADIs will be expected to submit formal CLF application by 30 May 2014 to determine the size of an ADI's CLF that will apply for the 2015 calendar year.

Risk management In 2013 APRA released a consultation package for the harmonisation and enhancement of its requirements for risk management (referred to as CPS 220). In January 2014, APRA released the CPS 220 in its final form coupled with a proposed prudential practice guide on risk management and a response paper (that addresses submissions received by APRA on the CPS 220 consultation package released in May 2013). An amended Prudential Standard CPS 510 Governance (CPS 510) was also released which is intended to ensure that governance requirements related to risk management are aligned with those of CPS 220. There are no material changes to the standards. There are however amendments to accommodate the independence and structure of the Chief Risk Officer function and certain relief being afforded to Australian branch operations and smaller ADIs.

Financial Claims Scheme Compliance with the single customer view (SCV) requirements of the financial claims scheme was required as at 1 January 2014, unless an extension of time was sought and obtained from APRA. Organisations have been working to develop compliant solutions while awaiting further guidance from APRA on key scheme elements, such as 'end-of-day' treatment of uncleared funds, and 'to the extent practicable' with respect to SCV data and payment instruction information which is in addition to the FAQ guidance published by APRA in January 2014.

During 2013, ASIC progressed with its market conduct reform agenda, particularly in areas of advice and 'OTC Derivatives'.

'Over-the-Counter Derivative Reforms' The first of the derivatives trade reporting dates commenced in 2013 with all CFTC (US Commodities Futures Trading Commission) registered swap dealers being required to report transactions to licensed trade repositories. Reporting requirements for other financial institutions and intermediaries in regard to certain transactions commence in April and October 2014 respectively, with the first phase of position reporting for CFTC swap dealers also commencing in October this year.

While the decision by the CFTC in December 2013 around 'substituted compliance' is set to ease some of the anticipated compliance burden on Australian CFTC registered swap dealers, differing regulatory requirements across various jurisdictions continue to pose implementation challenges.

Financial Advice While the FOFA (Future of Financial Advice) reforms came into full effect on 1 July 2013, proposed amendments were published for consultation on 29 January 2014. The proposed changes include the removal of the 'opt-in' requirement for planners, the amendment of existing grandfathering provisions and also the proposed amendment of the best interests duty to allow for the provision of scaled advice.
The regulator continues to be active in its surveillance activities and has been recently focused on areas such as insurance advice. With privacy and FATCA deadlines also drawing closer, project teams are now under pressure to ensure timely compliance.

From compliance to business advantage While each new regulation is aimed at achieving global or domestic policy objectives, the cumulative effect has, unsurprisingly, resulted in a significant cost burden on organisations. For these reasons, compliance teams are under increasing pressure to translate compliance requirements into business advantage and to leverage synergies and commonalities across different regulations so that implementation costs are managed.
Identifying how regulatory change can be used to deliver business benefits will be particularly important for compliance teams as the regulatory change agenda looks set to continue well into the future.

What's new for 2014?

The focus for the financial services industry in 2014 will be on meeting key implementation deadlines for Over-The-Counter derivative reforms, FATCA and privacy regulation. Coupled with this, it can be expected that business units and the regulatory affairs and compliance teams will focus some of their efforts on the Financial Systems Inquiry.

The global financial crisis and recent scandals involving the mis-selling of financial products and market manipulation have damaged the reputation of key sectors of the financial system. While analysing the failure of key processes and controls to prevent such incidents, the focus of law makers and regulators is increasingly on behavioural drivers and motivation behind the activity – that is, the culture of financial institutions.

Conduct risk Conduct risk is a UK concept, and is the extent to which financial institutions need to demonstrate the management of client interests across every part of their business operations.
While Australia does not have an all-encompassing set of rules covering conduct risk, new legislation and guidance captures elements of conduct risk regulation, for example, FOFA requirements, regulatory guidance around credit selling, and aspects of credit legislation. It is expected that these themes will continue to grow in terms of regulatory strategy and focus.
As the US, UK and Europe continue with their respective enforcement action and policy agendas, the industry will need to monitor these developments to understand the potential impact in Australia of any changes in the regulatory environment in these off-shore jurisdictions.

Insider Trading 2014 is likely to see a continuation of, or even an increase in, insider trading prosecutions as ASIC applies new surveillance technology and encourages increased market awareness. Publicly listed corporations will come under increasing pressure to enhance both their share trading policy and their policies and practices for managing price sensitive information.

AML/CTF, sanctions Anti-money laundering programs will continue to be in the spotlight, firstly through a broad review of Australia's existing AML/CTF laws and secondly, through the assessment of the effectiveness of Australia's anti-money laundering regime by the Financial Action Task Force.

Fraud/cyber-crime/corruption & bribery Fraud and cyber-crime are and will continue to be exploited in new ways and directions through emerging technologies, payment channels and business models.
Australian banks, along with government regulatory bodies, will need to continuously assess and manage the risks and promote confidence in the sector.

Technological change is increasingly facilitating the threat of cyber-crime. This form of crime has indirect impacts on consumer trust, along with direct losses.
The international nature of cyber-crime will continue to test both government and the corporate sector's ability to identify and prevent it.

An increasing number of governments are cracking down on corruption and bribery, often targeting foreign nationals operating in or through their countries, as exemplified by the recent prosecutions of Australian nationals in China and the Middle East.

Cross-border complexities The global crackdown on tax evasion is likely to be an equally important theme in 2014. Governments are under increasing fiscal pressure and the global efforts to prevent tax evasion, led by the G20, will be pushed onto the corporate sector, especially the financial services sector, by sovereign governments. New frameworks and agreements for governments and regulatory bodies to share information and intelligence will increase the ability of countries to claw back tax revenue. These agreements and attendant regulation to promote international co-operation are also likely to increase the regulatory complexity of cross-border business.

The bottom line

Banks should continue to leverage new data and technology to further develop an enterprise-wide view of risk, customers and counterparties.
As regulatory pressure flows down from the largest institutions, smaller banks should consider and/or reconsider the cost and risk of serving some customers or customer segments. This may well involve additional investment in compliance infrastructure, and a better integration of risk management from their board governance committees. While addressing cyber threats will be an ongoing concern in 2014, banks that pay greater attention to risk governance and communicate effectively with regulators, will be in a more favourable position to drive business growth.

Using data for capital efficiency and integrated reporting

While banks globally are facing increased pressure to drive shareholder value, local institutions have been able to increase dividends from strong profits and slow growth in risk-weighted assets, despite compressed margins and low loan growth. The Australian banks have outperformed their peers in total shareholder return (TSR) in the Asia Pacific region and globally, as well as in the broader ASX 200 market. (See Figure 3).

HQLA Despite this, the prudential regulator APRA has said banks are not doing enough to incentivise executives, likely to include chief financial officers and corporate treasurers, who are charged with managing their balance sheet to maximise the diversity and liquidity of funding sources.

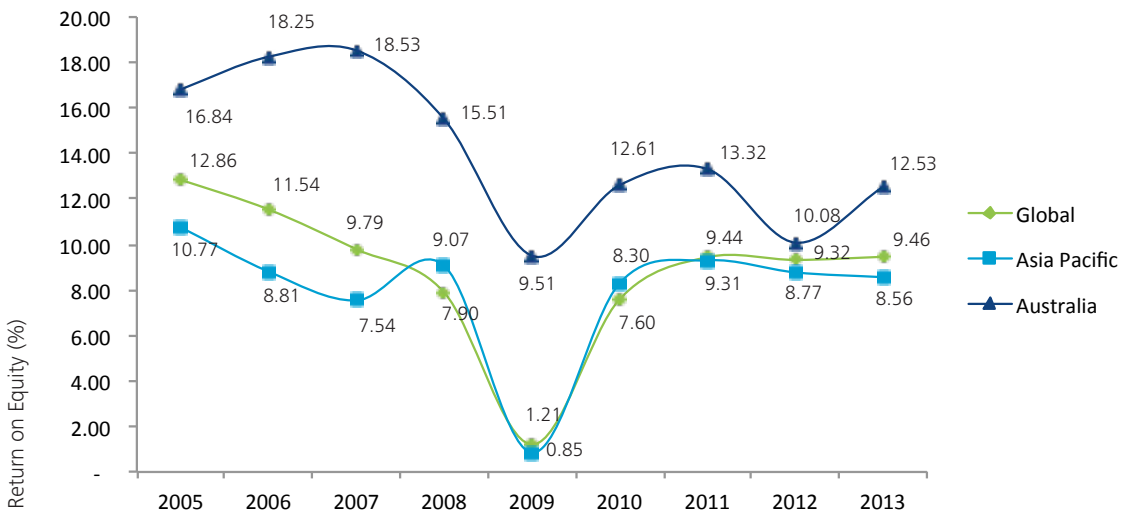
To meet the deficit of High Quality Liquid Assets available in the domestic market, APRA announced in January 2014 that the Reserve Bank would need to provide an undrawn facility of around $289 billion in total to all banks. This will cover expected cash outflow of $418 billion in 2014, plus a contingency buffer.

Implications The facility is almost $50 billion less than the combined total of estimates given to APRA by the banks late last year. It is likely to impact the country's smaller banks in particular, as they will need to improve their ability to assess the risk to their liquidity reserves of new loans and funding. It is costly to get the right systems in place to apply the liquidity 'charges' for bankers. However the infrastructure to be able to give that price to a front-line banker to publish every week is not easy.

Once the Committed Liquidity Facility (CLF) is in place, it will reinforce banks' hike in demand for deposits after the financial crisis, which will mean term deposit interest rates will stay higher permanently than they have been historically.

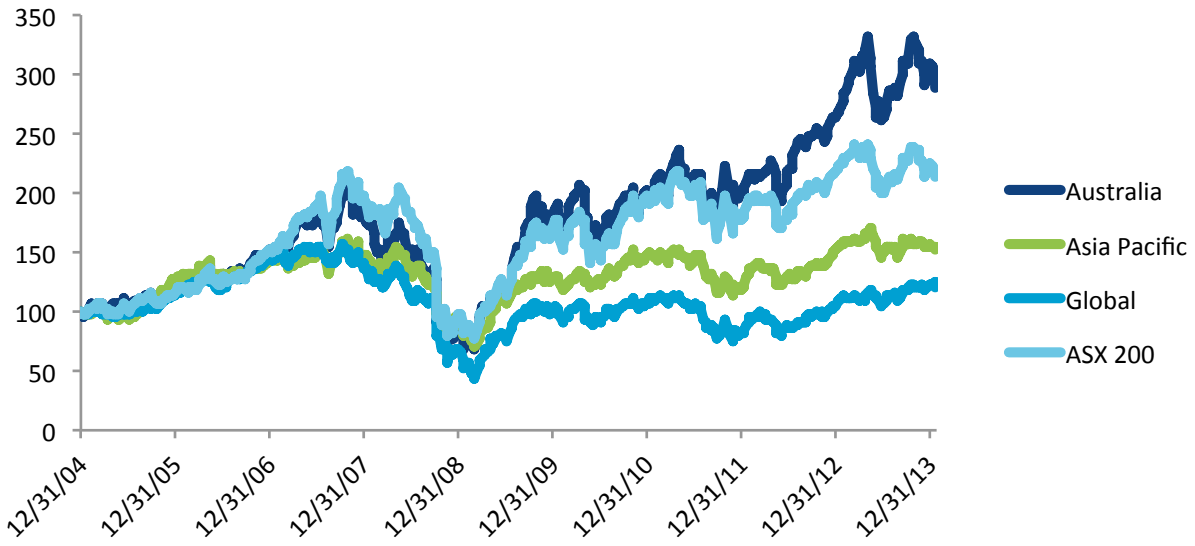
Return on Equity Although Australian banks also consistently perform better than their global and Asia-Pacific peers on ROE, the current returns on equity are below pre GFC levels and have dropped further recently due to less than average performance of some regional banks. See figures below.

Figure 2. Australian banks have consistently performed better than global and Asia-Pacific peers. However the current returns on equity are below pre GFC levels



Source: Bloomberg: Analysis includes banks with total assets >US$10 billion (2013)

Figure 3. Banks in Australia have generated tremendous returns to shareholders and have outperformed their peers in Asia Pacific and worldwide



To help support additional business demands, the role of the chief financial officer (CFO) has evolved to be more strategic in nature, especially involving efficient capital deployment and strategic growth opportunity evaluations.

As part of this change, finance functions are making substantial investments in integrated reporting capabilities, analytical skills and the implementation of consistent approaches to data governance which are designed to harvest greater value from their information assets.

What's new for 2014?

With continued pressure on interest rate margins and potential interest rate volatility, earnings are likely to be challenged on multiple fronts. Bank CFOs could be challenged to manage interest rate risk in the securities portfolio. Aside from developing prudent interest rate strategies, banks must also consider some of the related accounting implications. While losses from the available-for-sale portfolio may hurt capital, classifying securities as held-to-maturity could impact liquidity and saddle a bank with lower yielding assets as rates rise. Interest risk will likely continue to be a focus for many banks.

Also despite ongoing interest in M&A by a number of industry sectors, bank CFOs are still primarily focused on organic expansion and cost containment. Cost management remains the biggest risk and challenge for 2014 (as it was last year), followed by cash flow, competition, regulatory issues and global economic uncertainty.

So despite the encouraging outlook, most bank CFOs also feel pressure to optimise capital through growth initiatives or return excess cash to shareholders. The same rising global rate curve will impact securities portfolios for Australian banks, with corporate debt ratios likely to remain at near historic lows and low interest rates continuing to encourage accelerated mortgage pre-payments. These pre-payments will, however, offset new lending commitments with a resultant impact on net loan growth and profits. However refinancers and investors will return to dominate the Australian mortgage market over the next three years. With the ASX at its highest level for five to six years, and good yields scarce, a lot of investors are expected to return to property.

CFO response

Australian bank CFOs will more enthusiastically leverage and evolve data and analytics to drive profitability and capital allocation decisions. In this environment, improved reporting to understand profitability and return on capital, and a finance infrastructure that supports diligent cost management will become more important than ever. Disciplined expense controls will be necessary to enable banks to make many needed investments.

Banks will also be required to review operating models as they further adapt to the limited growth environment. This may also see divestment of non-core loan portfolios or businesses.

Stress testing, Basel III, and capital planning requirements (see our article on 'get to strong' p.8) may drive two priorities for Australian bank CFOs:

1. Maintaining the capital base with a particular focus on tangible common equity
2. Building a new finance infrastructure that can provide accurate and reliable data for capital and cost allocation decisions.

Banks looking to create advantages in 2014 may consider integrating capital efficiency tools at the business level with real-time capital allocation tools, and advanced scenario planning, to enable more informed risk-and-return decisions.

The bottom line

Improved reporting infrastructures and analytics are likely to be essential to strong financial management in 2014. In light of many earnings headwinds, CFOs can support profitability through more data-oriented investment decisions, improved capital deployment, and more diligent cost management. Better targeted customer analytics may also yield greater revenue opportunities. These efforts, along with stronger capital rules, may result in improved yet less volatile earnings in the future.

Building organisational agility for operational effectiveness

Banks today need new operational approaches encompassing ideas on how best to invest in and deploy technology to make the banking organisation more effective. But technology by itself is not a panacea for operational inefficiencies. It also needs appropriate governance mechanisms and leadership to be effective. Given these realities, banks need a new guiding principle to move ahead in an uncertain future. Organisations may need to embrace change and reinvent themselves to succeed.

What's new for 2014?

Agility will be the key to capitalising on future growth opportunities in an increasingly volatile and uncertain world. Agility is the ability to rapidly and thoughtfully respond to changing conditions, moving seamlessly from one position to another. To assume this virtue, banks should consider building agility in three areas – strategy, ecosystems and mindsets. (See Figure 4).

Agile strategies

In a dynamic VUCA world agile strategies allow organisations to continually innovate. The strategies are specifically devised to improve flexibility and responsiveness and so remove obstacles which prevent the organisation from moving easily and adapting quickly. Regularly generating and testing robust, strategic 'what if' scenarios to develop considered responses is an important quality of an agile strategy.

Banks, for instance, can create greater strategic agility for example by responding to evolving product channels like mobile payments, by streamlining decision processes and adopting new technologies.

Agile ecosystems

Agile ecosystems are modular operating models, combining internal and external networks that let firms seamlessly modify operations to meet customer demands or adapt strategies as circumstances change. One example is to reduce costs by creating shared services operations that are agile for standardised yet costly processes that often change or could be modified to provide incremental enterprise value, such as Know Your Customer and Anti-Money Laundering compliance. Another is considering whether to and how to partner with non-traditional players.

Building efficiencies in the traditional branch channel and fundamentally rethinking an organisation's cost structure can also contribute to agile ecosystems. In light of cost pressures and with an increasing emphasis on cross-selling, banks are already beginning to rethink their branch configurations. Deploying kiosks and advanced ATMs to deliver services at a lower cost while automating once-manual processes in a way that can be modified quickly and inexpensively as customer needs evolve, will further contribute to an agile ecosystem.

Agile mindsets

Building agility in the minds of executives, management and staff is critical. Developing agile minds is about building flexibility into the workforce to enable quicker responses to changing market conditions. The core element of an agile mindset is greater ownership and accountability of people to get the job done. Agile mindset organisations have:

- High sharing of tacit knowledge
- Greater accountability
- Continuous improvement of enterprise bench strength
- Professionals who can absorb ambiguity quickly and interpret and dissect changes
- Modular workforces that can seamlessly shift on the basis of need.

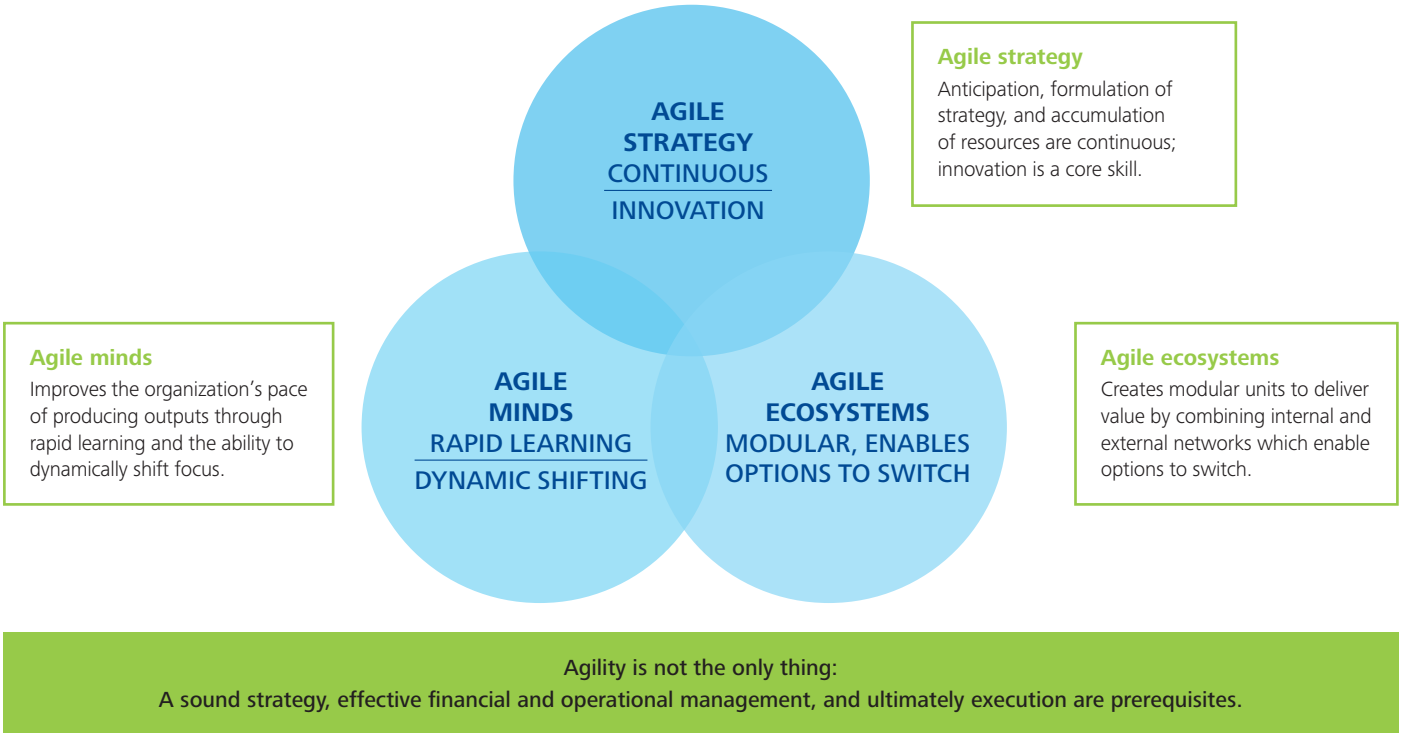
Acquiring and developing agile leadership expertise – especially in operations, technology, finance, and compliance – will continue to be a priority and also a challenge, as these resources are in high demand. Creating the right culture, along with incentives that support fast thinking and creative solutions, can help banks create new efficiencies and better ways to capitalise on growth opportunities.

The bottom line

While the future remains uncertain, building agile strategies, ecosystems and mindsets will leave banks well prepared for future challenges and opportunities. Agility will enable banks to make quicker decisions, scale up and down more efficiently, and become better innovators. These are the traits that will set banks apart from the pack.

Figure 4. Three characteristics of organisational agility

To combat uncertainty, agility will become a key determinant of success...



Source: Deloitte Australia

Supporting growth while bolstering infrastructure

The Australian banking sector has seen some substantial and high profile technology investments with more planned over the coming two or three years. Even where core systems are yet to be touched, mobile and digital initiatives are receiving particular attention.

In the area of big data and analytics, while many banks are enhancing their capabilities and leveraging these investments, real-time decision-making and delivery of superior customer experience still remain out of reach for most banks[8].

But amid these developments, there remains a real concern about various technology risks. Given the increasing reliance on technology, banks are investing significant resources to resolve inaccurate data, inconsistent reporting, and system glitches with the ability to quickly disrupt a bank's operations, strategy and reputation. In addition the increasingly sophisticated cyber-attacks, with the fraud and operational risks they pose, mean that security will remain a top concern for banks and regulators[9].

What's new for 2014?

Simplification Banks are looking to technology to help simplify the banking experience for customers and to increase the speed with which new products can be brought to market. To this end technology will be at the centre of almost everything banks do in the areas of growth, innovation, compliance and operational efficiencies. Simplification also enables banks to reduce cost, reduce risk and increase agility.

Customer experience Technology investments are likely to have a clear focus on growth, customer experience and security. Creating a differentiated customer experience that unifies mobile, online and branch channels in a more seamless fashion will further enhance banks' value propositions.

Leveraging data Banks could also be looking to grow revenue by leveraging data assets and technology to better understand consumer spending habits, preferences and product demand. Striving for real-time processing, tracking and decision-making will help create a world of greater efficiency and success.

We have seen a huge investment in technologies which have the capability to transform banks' relationship with their customers, including investments in big data analytics, and social and mobile channels. These investments allow banks to obtain a greater understanding of their customers' needs and empower customers to interact with their bank in a way that is most convenient for them.

Corporate mobile The market for corporate customers is particularly rich with significant opportunity to use technology, including corporate mobile solutions to create more value, reduce risk and drive more revenue. Using technology as the key enabler, banks can develop solutions that allow corporate customers to consolidate payments, track and process foreign taxes more efficiently, and better manage travel and expense budgets.

Compliance and risk management systems
Strengthening compliance and risk management systems is expected to be an ongoing concern. As cyber risks become more pronounced, the industry should continue to strengthen its defences across the threat landscape. Improving risk governance, adopting a more holistic approach to cyber-security and getting the board and the C-suite more engaged in cyber risk management, are all likely to be crucial.

Similarly it can be expected that banks will continue to focus on regulatory issues across their businesses including KYC, market surveillance, and the impact of prudential requirements on capital optimisation.

Lastly, to enhance the effectiveness of large-scale technology transformation projects, business leaders may need to be more engaged in execution, perhaps co-leading these initiatives with IT leaders[10].

Figure 5. Technology is a central driver of business priorities

Revenue growth
Enhance customer experience with better digital offerings. Leverage data from compliance infrastructure and use analytics to gain meaningful insights.

Risk and compliance
Strengthen compliance and risk management systems, and get the board more engaged in management of cyber risk.

Operational effectiveness
Enhance effectiveness of large-scale technology projects with more engagement by IT leaders in execution.

Source: Deloitte Center for Financial Services

The bottom line
Improved technology is the cornerstone of many industry priorities. As needs are numerous and varied, banks need to have an enterprise-wide view on technology investment and focus on major priorities. Creating a more seamless customer experience across all delivery channels, improving security to thwart cyber threats, and upgrading data collection and analysis to support growth and customer service as well as regulatory requirements, will be essential. Banks should seek to leverage recent investments in compliance infrastructure to improve cross-selling and grow revenue, while keeping an eye on the upcoming work on real-time processing and decision-making platforms.

Next steps in repositioning for growth

In 2014, banks are likely to continue sharpening their strategic focus while concentrating efforts in areas where they believe they have the best chance of boosting return on capital. To achieve this, finance executives will expand capital management disciplines across the organisation.

Recognising that customer experience will be the most fertile ground for differentiation, banks may leverage technology to improve their value proposition in new ways. Innovation is likely to be extended to new frontiers, with quicker progress towards a unified digital and branch experience.

The industry as a whole is becoming better acclimatised to regulatory scrutiny and this pressure is unlikely to dissipate in 2014 as the Financial Systems Inquiry re-examines the nature and effectiveness of financial regulation. Risk management systems and compliance infrastructures will continue to be enhanced, but not fully at the expense of business growth investment.

Many of the ideas mentioned above will rely on technology, especially new digital platforms, to drive superior performance and enhance customer experience. While core banking transformation might happen only at a moderate pace, banks will seek to bolster their technical defences to minimise the negative operational impacts from cyber-attacks.

Executing in our VUCA world will require banks to be more agile and innovative. Organisations not able to adjust to continually changing customer wants and requirements, technology changes and changing external environments, will be at a distinct disadvantage.

This is why we believe that while the priorities may seem varied at the surface, the overarching theme for 2014 will be an industry repositioning for growth through agility in the re-regulated world.

Endnotes

[1] Datastream defined World Banking Index – Market capitalization – January 31, 2014
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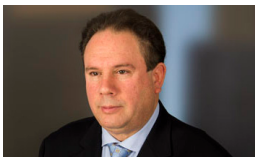

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