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Navigating the challenges and opportunities in financial services

Focus 2015

Executive summary

In 2015 the financial services industry will continue its focus on how best to evolve the customer relationship given the backdrop of continued disruption and ongoing political and regulatory uncertainty. While there are many things at play across the sector, customer, disruption and regulation are high on the agenda this year.

The good news is that there is easy money globally, strong US growth, and falling commodity prices, which despite the short-term impact on Australia, are all translating into lower bills and rising spending power for Western consumers.

In the context of the global economy and the significant work that's been undertaken by Australia's financial institutions since the Global Financial Crisis – both imposed and voluntary – we believe that this year the industry is poised to take advantage of these shifts.

In the following pages we consider five areas of focus for changing and improving the customer relationship and experience, and outline the opportunities and challenges of upcoming regulatory change, including the risks of conduct, culture, reputation and cyber security.

We trust this document will be thought provoking and trigger further perspectives.



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2015: The year to progress customer satisfaction

Financial services companies have historically 'under-delivered' in customer satisfaction, despite our customer centric mantras. You can choose different countries, languages, cultures, even different segments within financial services (banking, insurance, wealth), and you will consistently find a 'customer centricity' message.

So you would be forgiven for thinking, with similar aspirations across the industry, that the customer satisfaction agenda has succeeded and that 'customers are really happy'. However, evidence shows that customers' satisfaction, confidence and trust of not just the financial system but of business as a whole, is at low levels. The world's emerging leaders – a survey of some 7800 tertiary educated millennials (born after 1982) – believe only half of the world's big businesses behave ethically and three quarters focus on their own agenda, rather than considering their impact on society.

Trust is an elusive courtship. For a long time, all customers wanted from financial services companies was 'trust'; trust that their savings would be safe, that they be given accurate information and their provider would be there when needed.

However crises of confidence continue to happen across the industry post Global Financial Crisis (GFC), with GFC losses exacerbated by subsequent misselling, misconduct, and poor advice, further eroding trust.

While 'trust' is the major banks' biggest asset (70% of customers would trust their main financial institution's mobile wallet solution vs 15% for other institutions in Australia), the payments challengers that are ramping up their offerings, are becoming more trusted (eg PayPal, Visa/ MasterCard, Google and Apple). Their penetration is expected by Deloitte experts to be boosted by 30 million near field communication equipped smartphones globally that will be used at least once a month to make contactless in-store payments at retail outlets.

Customers as a source of disruption. As the phenomenon of social media and the sharing economy continues, the trusted relationship with customers as we know it today will continue to be challenged.

At the simplest level social networking and social media have transformed the customer relationship. They are not merely a 'consumer' of services; they are an active voice in shaping at every step in the value chain.

Deloitte Millennial Survey (Davos 2015)¹

They focus on their own agenda rather than considering the wider society	 75% Agree	 23% Disagree
They take a strong leadership position on issues that impact wider society	 61% Agree	 35% Disagree
They show stronger leadership than governments on important social issues	 61% Agree	 35% Disagree
Their leaders are committed to helping to improve society	 53% Agree	 44% Disagree
They behave in an ethical manner	 52% Agree	 44% Disagree

1. See Deloitte Millennial Survey for Davos 2015
<http://www2.deloitte.com/tr/en/pages/human-capital/articles/the-deloitte-millennial-survey-2015.html>

Barclays Ring MasterCard, the first credit card to put members in control, is an outstanding example of how involved the customer is becoming in defining the next product innovation, in marketing and selling the brand and in sharing in the profitable returns that they have contributed as a loyal customer.

But more radical than this is the customer's role as a competitor, with business model disruption no longer the domain of the start-up alone. We-commerce, the maker market, the sharing economy; all these terms represent the increasing role customers are playing in disrupting the financial services value chain.

The convergence of digital, data analytics and social media, is liberating customers from the financial institution's guarded role as the physical safe haven of financial security. At the heart of the sharing economy's success is a consumer's willingness to place their trust in one another; to give and receive information that will allow them to participate in the financial market as a lender, borrower or investor. Brokering these relationships are the lending clubs, like Zopa and Society One, in the sharing economy. And Moula and Prosper are creating new value propositions in the start-up community. While PayPal and Google for instance are building alternatives to core financial infrastructure.

Give customers what they want. Historically institutions focused on providing customers the right product at the right price. However, customers want more, they are looking for value, but as with beauty, value appears to be in the eye of the beholder.

Roberto Verganti's research on design-driven innovation also exemplifies this idea. He outlines a view that innovators must look beyond the current value of products and services to redefine core 'meaning' for the customer.

A new generation of customers are finding value in unexpected places. Take Telstra and Australian Super for example. They enjoy an engaged customer community from those who help others solve their technical and product offering problems. Capabilities to allow crowd sourcing (the ability to pose questions and receive answers) have created communities of people transacting for recognition. Customers appear to be gaining a deep satisfaction when they are recognised for their knowledge. Customers are building their own personal brand through communities and new brand heroes are emerging.

In a post digital world, the old propositions are not enough. Take a traditional car dealership for example. Their core source of value used to be providing 'information' to customers about the cars they were selling. However, with the increased amount of information available digitally, customers became more informed than the dealer. Dealers' propositions required a rethink, and as a result, dealers increased their focus on 'test drives', in other words, a chance to experience the car.

In financial services, information and comparison is easier than ever. Customers look for more value from their institution. They are looking past product and service towards experience and personal /brand recognition. Will financial institutions allow customers to 'test drive' their products? Who will be the hero of your brand?

So, what will it take for FSI customers to feel the difference? How long will banks, insurers and wealth managers wait for disruptors to become major hurdles to their business? Or will they wait for successful initiatives and then acquire them? Given the time, effort and resources that are being invested in responses to regulatory pressure, we anticipate that 2015 could be the first time a disruptor achieves a significant win against incumbents. Therefore, we propose five areas of focus for this year:



Implement customer-centred design capabilities

Most organisations have failed to capture customer input effectively when developing new products, reviewing existing processes, or assessing new business models. Techniques that embrace ethnographic enquiry, co-creation and ideation as well as rapid prototyping and customer feedback are capabilities that underpin a customer-centred design approach. They are the capabilities that organisations such as Lending Club, Prosper and many of the disruptors, have built into their DNA. By working with customers and listening to their concerns, these opportunities can drive the development of innovative and differentiated product offerings and customer experiences that customers value highly.



Focus on customer outcomes

Across acknowledged leaders such as Facebook and Amazon, the words 'sales, revenue, margin and cost' are replaced with 'usage, # orders per minute, and return on feature'. Goals are defined in terms of the customer, and the customer's engagement with the organisation's offerings, which are measured religiously and by all levels of the organisation. Products are not sacrosanct – they are readily refined, turned off, dismantled and rebuilt through interacting with customers and monitoring their behaviours daily. The organisation focuses on the customer outcome. Product, sales, marketing and service teams adapt and fine-tune every step of improvement based on engaging the customer – not as an NPS score - but as a measure connected to the customer in real or 'near real' time. Adopting this tenacious and integrated view across the organisation for excellent customer outcomes creates the shift from 'saying' to 'doing'.



Bidding for your business – "be hungry"

Instead of continuing to hit the same note over and over again around becoming customer-centric, FS organisations, particularly in markets where trust has to be rebuilt from scratch, need to differentiate the way they interact with customers. They have and are turning the tables from an expectation of passive serviceable customers, to 'being hungry' in actively canvassing for individual business, communicating by deed and word that: 'We are here to bid for your business' and 'We can work with you to help you achieve your goals'.



Get closer to the customer through data and analytics

In the constant debate between centralisation vs decentralisation, no one disagrees that 'customer facing' activities need to be able to provide superior experience to customers. The question remains how best to do it! Certainly 'capable empowerment' (being able to make decisions closer to customers) is critical. This requires capability around data and the pursuit of innovation to be fully embedded in the cultural DNA of a truly 'customer-centric' organisation. Data is democratised and not 'owned' by any part of the organisation. All individuals should understand, interpret and use it for insights and decision making.



Create an 'ecosystem' where you and your customers mutually benefit

Most of us think of customers as 'the ones who buy our products and services', which is not how they think about us. They want outcomes, for example, to have 'peace of mind' in case something happens to their homes. We call it 'property insurance'. They want the ability to transact across any channel, as well as to migrate across channels with ease. We call it 'omni channel'. How can we help to solve their problems as businesses? One way is to leverage our relationships to create connections among our clients. For example, American Express's OPEN forum helps small business owners connect with each other. This not only helps the customer succeed but also, makes them our advocates as small business partners.

To stave off competition and preserve trust, banks, wealth managers and insurers will need to continue to build their capabilities in delivering real time services, offering an omni-channel presence, with services that add more value by making better use of their customer knowledge before someone else does. Given the challenges, Macquarie Equities Research for instance expects each major financial institution to add up to A\$ 3 billion to their IT investments over the next four years.

The last word

Given the FS inquiry and how quickly disruption is reaching the market, there is a real chance that 2015 will be the 'inflection' year for multiple channels and behaviour-focused products and services. The big question is – Are you harnessing the possibilities of innovation to leverage the power of the disruption bang for your customers?

Regulatory challenges are set to extend beyond 2015...

Regulatory policy development and uncertainty will remain the order of the day, despite 2015 marking the seventh year since the financial crisis. Significant reform work continues at the global level under the auspices of the G20, while at home the Financial System Inquiry (FSI) moves into its next phase with the final report open for consultation until March 31, after which the government will determine its response.

Outside formal policy development, pressure also remains on governance and culture across the sector, while investigations into practices within the industry are ongoing. This adds up to our expectation that 2015 will be another year where regulatory issues will occupy much of an organisation's strategic thinking, and project spend through implementation and remediation will continue to be a major pressure point for business. Working together to co-design intelligent frameworks to meet, manage and anticipate these issues will be increasingly valuable.

What is happening in 2015?

Banking: Significant reform of the Basel framework for bank capital is underway. There are several strands to this work, with a number of consultations underway and work-streams active. The Basel Committee has committed to reduce the variance among banks using internal models, to improve the standardised approaches, to put boundaries on the variance between standardised and internal models via a floor, and to enhance disclosure.

Overarching this work is the formal consideration of the Basel Committee of the future role of internal models in bank regulatory capital calculations. The bulk of this work is due to be completed by the end of 2015, with national implementation to follow thereafter.

All banks will be required to implement the new standardised model, including internal model banks due to the operation of the floor, which due to its more granular nature will require changes to data management in order to calculate capital ratios. It will further force a strategic rethink of capital allocation, and change the incentives inherent in the system. The operation of the floor will reduce the benefit obtained through using internal models, while costs will have increased due to the need to calculate and report both standardised and advanced metrics.

In addition 2015 will see the completion of the 'bail-in' standard for globally systemically important banks through the development of a Total Loss-Absorbing Capacity (TLAC) metric as an integral part of the Basel framework. While there are no formal plans to extend this requirement to domestically systemically important banks, this outcome has been giving a greater likelihood in Australia as a result of the FSI report, which recommends an Australian standard for loss-absorbing capacity 'in line with emerging international practice'.

Insurance: While the FSI in Australia has not recommended major changes to the insurance industry, international work has commenced on the first ever global insurance capital standard for insurers. This work is due to be completed by the end of 2016. While the final global standard is not expected to produce meaningful change in the level of capital required by Australian insurers, whatever the final standard, it will still need to be implemented and the standard may influence decisions on capital allocation. The work is at an early stage, but will move at a fairly rapid pace over the course of 2015.

Wealth: 2015 will see a continued focus on financial advice, with emphasis on remuneration, professional standards, and fiduciary duty. Internationally, under the work of the G20 on shadow banking, there will be further development of policy regarding the systemic riskiness of asset managers, which may well lead to the development for the first time of global prudential asset management rules over the course of the year. This will be a space to watch closely.

OTC derivatives: All financial service companies will continue to be impacted by the implementation of global OTC derivative reforms in 2015. Work on clearing, trading and reporting will continue, but a new challenge for 2015 will be the introduction and implementation across the sector of margin rules on uncleared trades. This appears set to suffer the same uncertainty and cross-border implementation challenges as other reforms in this space. And given the nature of the requirements will have significant business and system impacts.

Governance and culture: Sector-wide pressure will remain on firms to improve their governance and risk culture. Against a backdrop of continued investigations into industry practices, organisations will need to demonstrate robust governance and improvements in culture firm-wide².

2. *Link to Deloitte Risk & Regulatory Review – October 2014 – March 2015*

<http://www2.deloitte.com/au/en/pages/financial-services/articles/risk-regulatory-review-october-2014.html>

Conduct risk, reputation and cyber security: Although the majority of global companies (76%) – financial services and others - are confident that their reputations are strong³, some 39% of companies rated the maturity of their reputation risk management programs as either 'average' or 'below average'. So although almost 90% of executives in the Deloitte survey³ rate reputation risk as more important or much more important than other strategic risks their companies face there is still much work to be done.

Respondents from companies that had previously experienced a negative reputation event reported that revenue (41%) and loss of brand value (41%) were impacted most. Deloitte research shows there is an 80% chance of a company losing at least 20% of its value (over and above the market) in any single month, in a given five-year period, due to the impact of a crisis on reputation. In each case researched, the value loss was sustained. It is worth noting that customers are the most important stakeholders for managing reputation risk (81%).

In Australia there have been more than 20,000 breached records through cyber-security breakdowns over the five years to 2014⁴ – compared with just over 29,000 in the United States. Businesses need to invest in security and work with the support of strong IT teams, and external resources, to operate more effectively and securely in our digital world and engender and grow back that trust.

The last word

What does this mean for 2015?

Reforms are still being developed that will impact the sector. It is imperative that firms at a minimum continue to monitor developments, particularly in the international space. However, given the transmission of global reforms to the local market, organisations should seek opportunities to engage through writing submissions and participating in debates where appropriate.

The implementation phase is far from over. The continued spend on regulatory issues will require a long-term plan for optimising the regulatory spend, not just for the sake of the efficiency of the regulatory dollar, but more broadly to free up resources to focus on investment and business development.

The regulatory agenda will continue to impact strategy. The allocation of capital and resources to various businesses will continue to be challenged, and will require a keen focus on the regulatory outlook and its implications.

Establishing the right culture is critical. Organisations should assess and seek to continuously improve their culture. Achieving the right culture is challenging yet possible.

...continued pressure on strategy and regulatory spend

3. According to the 2014 global risk survey Reputation@Risk conducted by Forbes on behalf of Deloitte <http://www2.deloitte.com/au/en/pages/risk/articles/global-risk-survey-2014-reputation.html>

4. <http://www.ponemon.org/blog/ponemon-institute-releases-2014-cost-of-data-breach-global-analysis>

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