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2022 banking and capital markets outlook

Canada's financial institutions are cautiously optimistic

Considering the financial and economic turbulence brought on by COVID-19 crisis over the past two years, Canada's financial institutions have held up extremely well. Now, with the global economy slowly reopening, unemployment rates beginning to fall, and individuals and businesses ready to spend and invest again, the country's financial sector is preparing for a better 2022.

Deloitte's annual financial service industry outlook report, which surveyed business leaders from across the globe, including 236 Canadian executives, found that the country's financial institutions are cautiously optimistic about the industry's near-term performance.

In 2020, Canadian banks were forced to set aside $11 billion to cover potential loan losses—with millions losing their jobs, regulators were worried that people would default on their debt—which dampened revenues and profits. With default rates remaining low—even falling below Canada's historical average (thanks largely to financial supports from the government)—banks didn't have to draw on those reserves. The country's financial institutions can now use those funds to pursue more growth-enhancing investment opportunities in the year ahead.

To be sure, the sector is cognizant of a number of potential headwinds that might dampen growth. The emergence of new COVID-19 variants could slow reopening plans, putting the brakes on consumer and commercial spending (as seen by the emergence of the Omicron variant in Canada in late 2021). Furthermore, new policy directives, such as the proposed 3% tax on banking profits over $1 billion, threaten to weaken the short-term outlook of bank performance.

Despite this, bank revenues are expected to increase by about 4.4% in 2022 (based on consensus analyst estimates), driven primarily by strong credit performance. On the cost side, while inflationary pressures drive up personnel costs, Canadian banks are still expecting modest cost increases in the low-to-mid single digits.

While 2022 should be a strong year for Canada's financial sector, the report outlines a number of challenges and opportunities that financial institutions will have to consider in the year ahead.

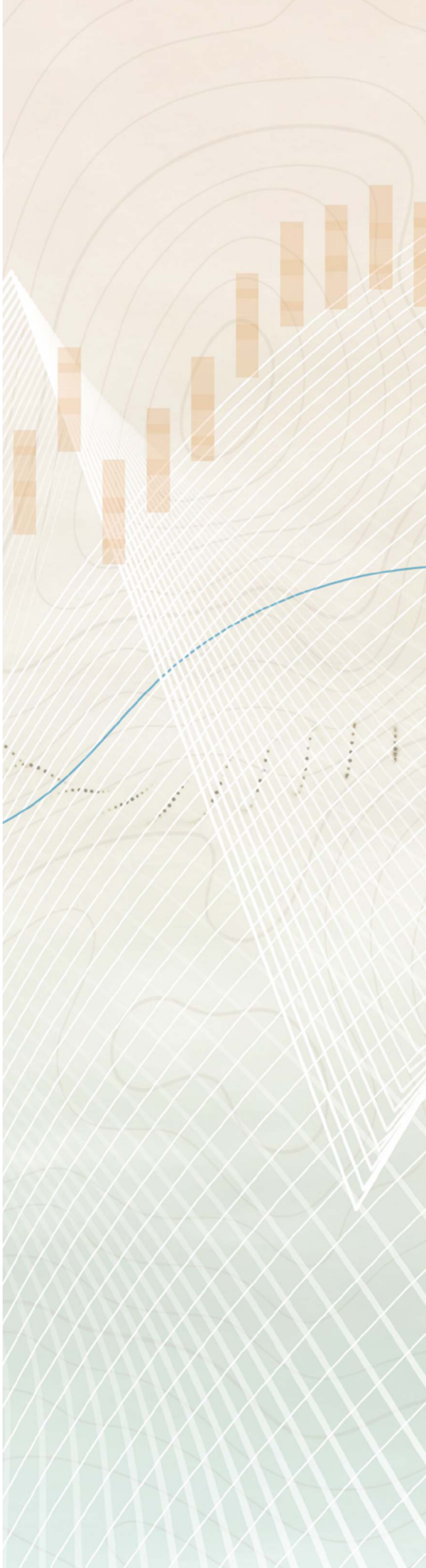
Opportunities and challenges for 2022

Employment:
trouble with talent

Client relationships:
making more personal connections

Technology:
investing in the cloud

Operations:
cutting costs and reducing risks



Employment: trouble with talent

It won't necessarily be smooth sailing for banks. Many executives are concerned about their ability to retain and acquire top talent in the year ahead, especially if there's an expectation that staff must come back to the office. According to the survey, just 58% of respondents expect their organization to pivot to some sort of hybrid work model—the rest want employees to come back to the office full time—compared to nearly 70% globally.

Generally, bank executives are worried that remote work could stifle learning, creativity, and collaboration. But a recent global survey found that over half of surveyed employees worldwide would consider leaving their job post COVID-19 if they were not afforded some form of flexibility in where and when they work. To retain top performers while providing some flexibility, banks will need to create a workplace that employees want to come back to—employee experience will be the new driver. Companies will have to invest in technology tools to make the hybrid experience seamless for all, creating an experience of digital equity where all stakeholders are included regardless of work location.

Younger workers are concerned about career advancement and are looking for coaching and mentoring with senior leaders. Organizations will need to ensure there is a balance of remote work at the senior levels to also ensure that knowledge transfer is cascading to future leaders.

Another challenge is around finding the right talent for a post-pandemic future. Four in ten executives said their workforce was not ready to adapt, reskill, or take on new roles during the pandemic. At the same time, with more investments in artificial intelligence, machine learning, cybersecurity, data science, and software development, companies will need to either find people who are adept in these areas or upskill existing staff. Indeed, 65% of respondents said that hiring tech talent is a major challenge, while upskilling is a top priority for 2022. This is a difficult issue to overcome, given that Canada's tech talent is still interested in moving south, where there's more money and more brand-name businesses to work for.

The workplace can provide the space required for the learning and development needed to deliver ongoing business process changes. Organizations are looking to transform large event spaces to learning and development spaces to give employees a reason to come back to the office and an opportunity to learn together. Learning and development spaces will be another amenity offered to employees, alongside enhanced wellness amenities.

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Client relationships: making more personal connections

Clients are increasingly interested in having a more personal connection with their financial institutions. While automation is still important—people want to bank faster and many don't want to have to wait in line at a branch—more than two-thirds of Canadian banking executives say that human interaction will become more important over the next three years.

To form that connection, banks need to have a purpose. Customers now expect companies, more broadly, to have some sort of overarching reason for being. They want the brands they interact with, including their banks, to articulate why they exist and what problems they can help solve. Fortunately, many of Canada's banks are ahead of the game, especially as it relates to climate change. For instance, all six of Canada's big banks have joined the Glasgow Financial Alliance for Net Zero (GFANZ), a global coalition of 450 financial institutions that have committed a collective $130 trillion in private capital to support the transition to net-zero.

Clients also want more access to their own data, from transactions to behaviours and everything in between. There's still a lot of headway to be made: a 2020 Deloitte survey of financial services companies found that just 22% of Canadians feel as if they're in complete control of their personal data. Nearly 90% of banking sector marketing executives agree that they're not doing enough to make people feel in control of their information.

That said, it's only a matter of time until consumers do have more control over their information. In April 2021, the Advisory Committee on Open Banking recommended that Canada implement open banking, a system that makes it easier for bank clients—and the third-party fintech operations banks use—to get consumer data from established financial institutions. The committee wants the data sharing to begin in January 2023, so 2022 will be an important year for banks to build the systems and processes required to promote data sharing.

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Technology: investing in the cloud

The pandemic has shown companies just how important it is to make use of flexible and adaptable technologies, such as the cloud. In 2021, technology budgets as a percentage of revenue in Canada were on par with the global average—27%—and spending is expected to increase by about 11% for 2022.

Much of that money will likely go to cloud-related solutions. In Canada, 60% of respondents said that their institutions are still dependent on legacy systems, while one-third of global respondents said the same. Just over 80% of executives also admit that their approach to cloud migration is neither strategic nor forward-looking.

There's also still more work to be done around AI, with most AI-related investments being limited to small-scale pilots and niche cases. Many executives lack a clear understanding of this technology's benefits and how to generate a return on investment, with most simply focused on using AI to reduce costs and increase efficiency.

Operations: cutting costs and reducing risks

One area that could see a lot of change over the coming year is operations. Most institutions are increasingly more focused on cost optimization, with 77% of Canadian executives listing it as a high or very high priority for their business. One way they're going about that is by hiring third-party managed service companies to handle everything from tax compliance to fund accounting to cybersecurity—areas that require more technical sophistication and an ability to rapidly respond to unexpected events.

Canadian banks also recognize the need to take more emerging risk disciplines, such as digital assets, cryptocurrency, and climate change, into account. Because most don't yet factor these issues into their risk assessments, risk methodologies may not be as robust as they should be. However, banks are planning to invest more in compliance, with 41% expecting a large increase in compliance-related expenses in 2022, compared to 20% of executives globally.

Brighter future ahead

While there are certainly challenges to contend with, Canada's banks also have a lot to look forward to in 2022 and beyond. Executives are interested in seeing how the fintech space evolves, with 78% saying nonbanks, bigtechs, and fintechs are good for competition and consumer choice. The country's financial sector is also poised to become a leader in the transition to net-zero emissions. According to the survey, 87% of Canadian respondents said that their institution is increasing their investments in environmental, social, and governance (ESG)-related areas—on par with the global figures.

With the pandemic hopefully soon to be in the rearview mirror, institutions are well positioned to take the Canadian economy into the future. With more than 280,000 people employed by these businesses, financial companies are leading the way on the return to work. As one of the largest contributors to the Canadian economy, their profitability will help buoy this country's fortunes. With their focus on ESG, they're helping create a more sustainable future. Canada's financial institutions have always been a driving force for this country, and that will only continue in the years ahead.

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