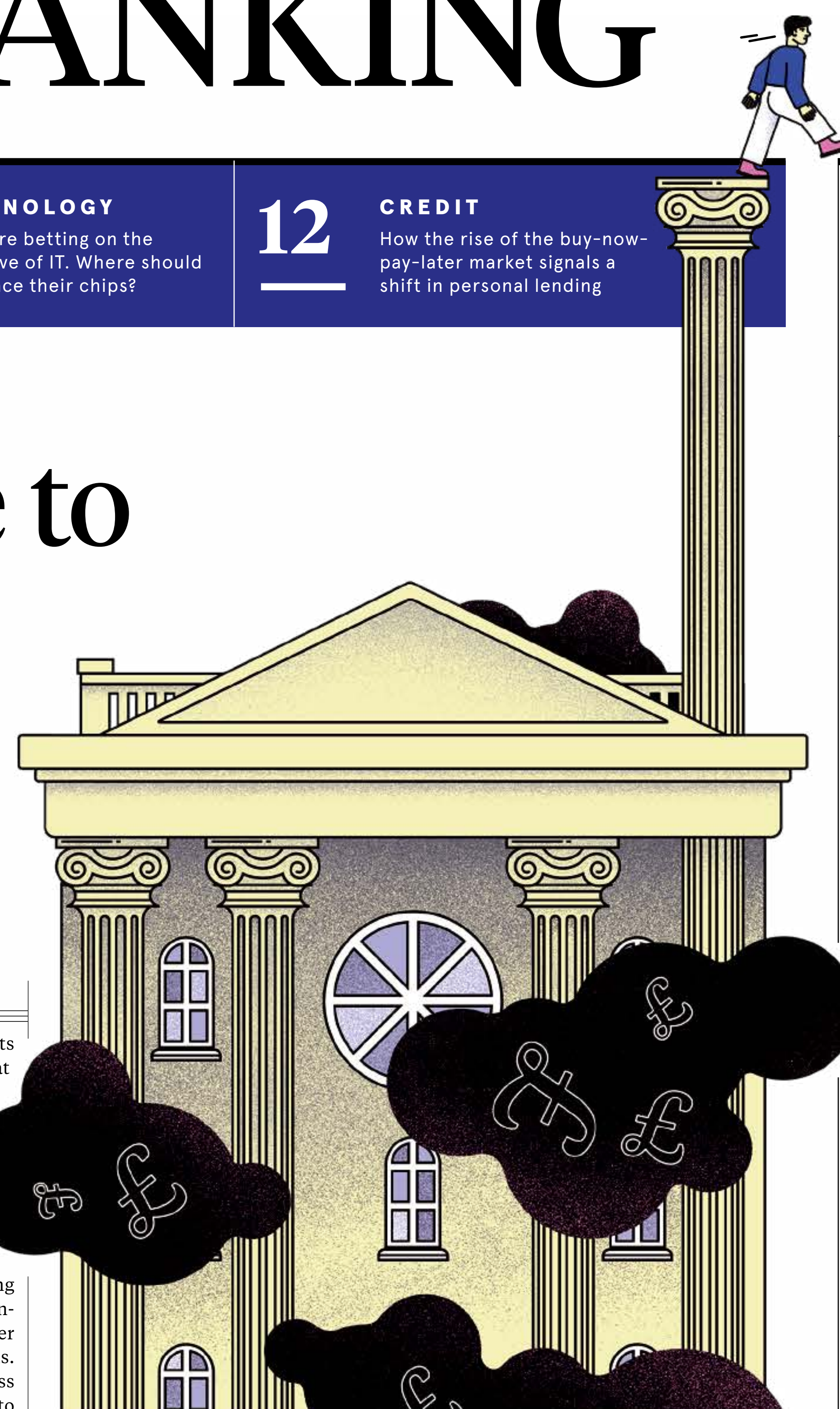
FUTURE OF BANKING



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SOCIOECONOMICS

Should banks do more to help customers in the cost-of-living crisis?

British households are facing the steepest fall in living standards in 70 years. It's putting the sector under pressure to step in like it did when Covid struck

Fiona Bond

Consumers could be forgiven for thinking that the past two years have been a case of jumping out of the frying pan and into the fire. After the pandemic wrought havoc on global economies, the recent surge in inflation to a 30-year high has triggered a cost-of-living crisis in the UK.

Tax hikes, along with the soaring costs of energy, fuel and basic groceries, have meant that living standards – as measured by disposable household income – are on course to fall by 2.2% this year, according to the Office for Budget Responsibility. This represents the biggest drop in living standards the UK has seen since records began in the 1950s.

The statistics paint a bleak picture for consumers, many of whom suffered financial hardship during the pandemic as successive lockdowns led to furlough, pay cuts and redundancies. January's *TSB Money Confidence Barometer* indicated that 82% of people had already experienced an increase in their day-to-day cost of living. As a result, almost a quarter had been forced to dip into savings, while a fifth had changed their spending habits.

The landscape is equally challenging for businesses. The pandemic has left many SMEs financially fragile, with significantly more in excessive debt than before Covid. As firms battle the latest crisis, the British Chambers of Commerce reports that half of them are cutting costs, while a fifth are cutting investment and 5% are thinking about going out of business entirely.

Are high-street banks and other lenders doing enough to help their struggling customers, both business and domestic?

Andrew Hagger is the founder and director of consumer site Moneycomms.co.uk. He notes that "there hasn't been additional monetary support from banks and, unless there is some pressure from the government on them to provide it, the situation is unlikely to change. Slogans in bank advertising include phrases such as 'by your side' and 'we're on your side' but these are sounding hollow. The banks will tell you they have introduced budgeting tools in their apps to help you track your spending. But, as far as tangible things such as cutting the near-40% interest rates on agreed overdrafts go, we've not heard a whimper."

> It would not make sense for lenders to take on an attitude of maximum recovery in our current environment of financial uncertainty

Back in early 2020, there was an unprecedented response from the sector as the Covid crisis took hold. Banks were instrumental in implementing several government support packages, including business loans, interest-free overdrafts and repayment holidays on mortgages, credit-card debt and other loans. It marked what many called a new era for banks after the 2007-08 global financial crisis. But, as customers face hardship once again, could it be too much for banks to contend with?

"For the banks we work with, the pandemic has not had a lasting impact on their ability to lend or offer support, reports Pradeep Raman, digital director at savings software provider Finova. "It is a bank's regulatory duty to take care of its customers, so it would not make sense for lenders to take on an attitude of maximum recovery in our current environment of financial uncertainty."

But the Bank of England has warned that excessive levels of debt among businesses can present risks to the financial system. Banks could therefore suffer losses if firms struggle to repay their loans. And, in a recent message to its business customers, NatWest has advised them to "be prepared for every eventuality and aware of the risks of overextension when borrowing in an environment conducive to rising rates".

Finn Houlihan, managing director of wealth management specialist Arlo Group, believes that banks may be restricted in the help they can provide.

"While they have offered some level of flexibility through holidays on loans and extended mortgage repayments, there is a limit to the flexibility they have to recuperate the borrowed money to avoid defaults of their own," he says.

For many business leaders, it appears that the onus is on them to assess the types and levels of debt their firms can sustain and make choices accordingly.

Industry observers believe that banks are likely to focus on providing educational support and resources. Since the financial crisis, when public trust in the system evaporated, banks have worked hard to restore their reputations and win over sceptical consumers. Many have introduced online money management tools to help increase customers' financial understanding. Houlihan believes that educational initiatives will be key in helping their customers through this latest crisis.

"While banks can only be so flexible with the relief programmes they create, there has been a real shift in terms of client service during the pandemic as part of a government push for education and open discussions with clients," he says. "Financial education, when combined with technology solutions such as open banking, can offer more long-term solutions for people to navigate their finances. This can help to put more information into the hands of consumers and give them a better grasp of their financial situations."

For example, the TSB says that its Spend & Save and Spend & Save Plus current accounts include features designed to help customers manage their money better. These include savings pots that allow them to put aside money easily and a function that automatically transfers money from a pot back into the current account should its balance fall below a certain level.

Raman reports that banks are proactively contacting customers to offer advice on their current expenses and alert them to potential problems. Similarly, mortgage lenders are approaching homeowners nearing the end of their fixed-term deals to advise them of the best products available.

There is certainly greater pressure on banks to help customers who might be struggling. The Financial Conduct Authority has called for stronger protection of "vulnerable customers" after its research revealed that nearly 27.7 million UK adults are displaying characteristics of vulnerability, including low financial resilience.

"How any forbearance packages or support are designed and delivered is a matter for individual banks and lenders," says Anna Roughley, head of insight at the Lending Standards Board. "Their response will depend on the individual customer's situation. This should be done in an empathetic manner, understanding the stress and anxiety that can accompany money worries. Banks and lenders should review how they encourage contact from customers and question whether there are ways to improve this that may increase the likelihood of proactive customer contact."

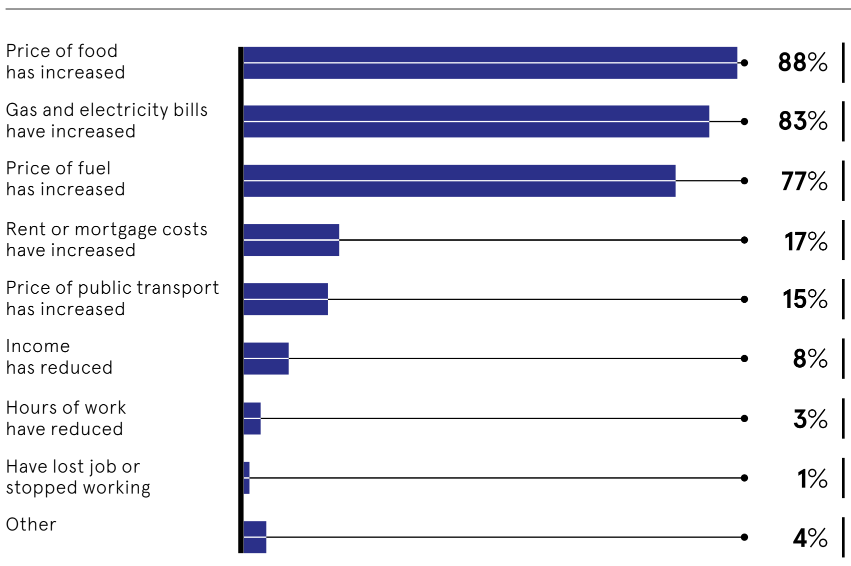
But for all the talk of a personal touch and greater financial education, there's still concern that this won't be enough.

"Although repayment holidays haven't been discussed at length yet, it would be good to see these reintroduced where necessary to avoid instances of unplanned loan defaults," Raman says.

Hagger adds: "Banks will face higher levels of missed loan repayments and bad debt when the cost-of-living crisis really takes hold. The government has so far given a £150 one-off council tax rebate and the promise of a £200 loan to pay electricity bills come October."

But he doesn't believe that these measures will be enough to help consumers cope with surging inflation. "The government will be forced to do much more," Hagger predicts. "Perhaps the banks will be roped in to help as part of a range of measures to help the country ride out this storm."

REASONS CITED BY UK CONSUMERS FOR INCREASES IN THEIR COST OF LIVING



Office for National Statistics, 2022

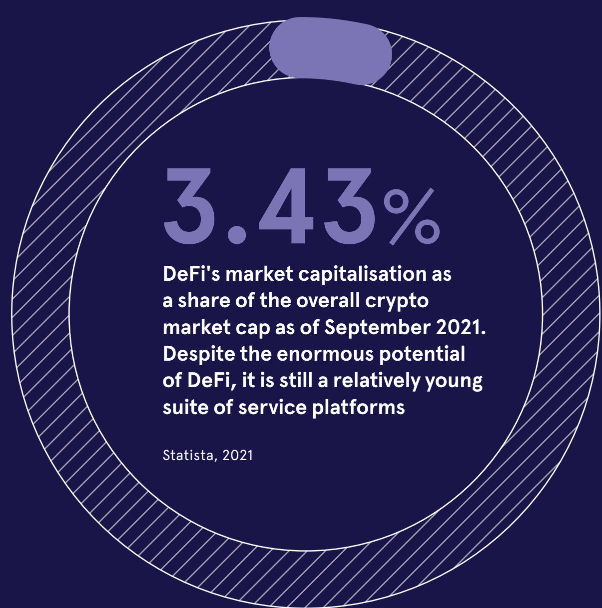
95%
Increase in UK domestic gas prices from April 2021 to April 2022

87%
of UK adults reported a rise in their cost of living in April 2022

House of Commons Library, 2022

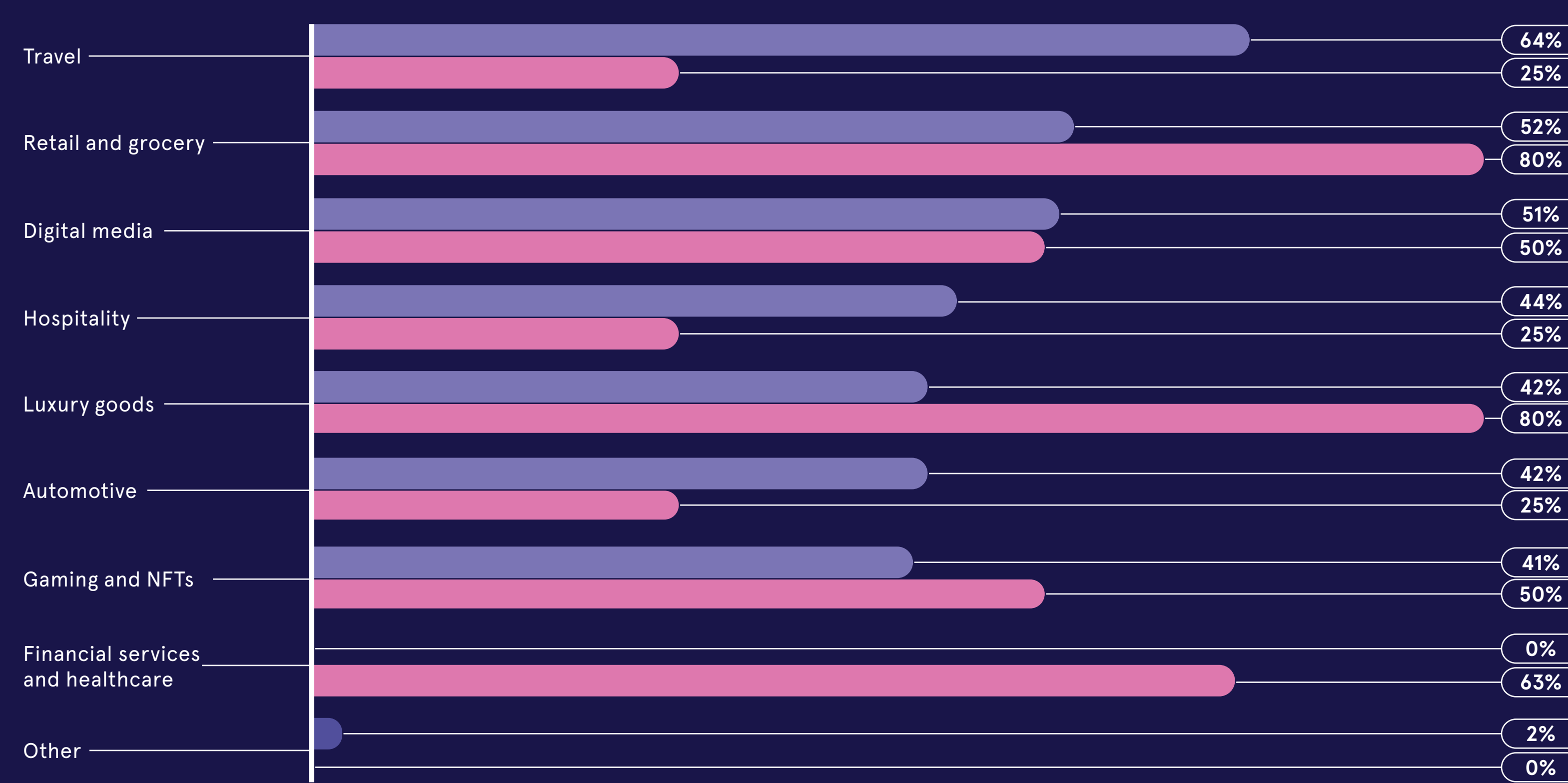
DECENTRALISED FINANCE

Tech-driven disruptions in the financial services industry have moved far beyond payments apps and bitcoin. Decentralised finance (DeFi) is a sophisticated blockchain-based infrastructure that has permeated the sector's whole ecosystem. But who is using DeFi platforms and how are they applying the technology?



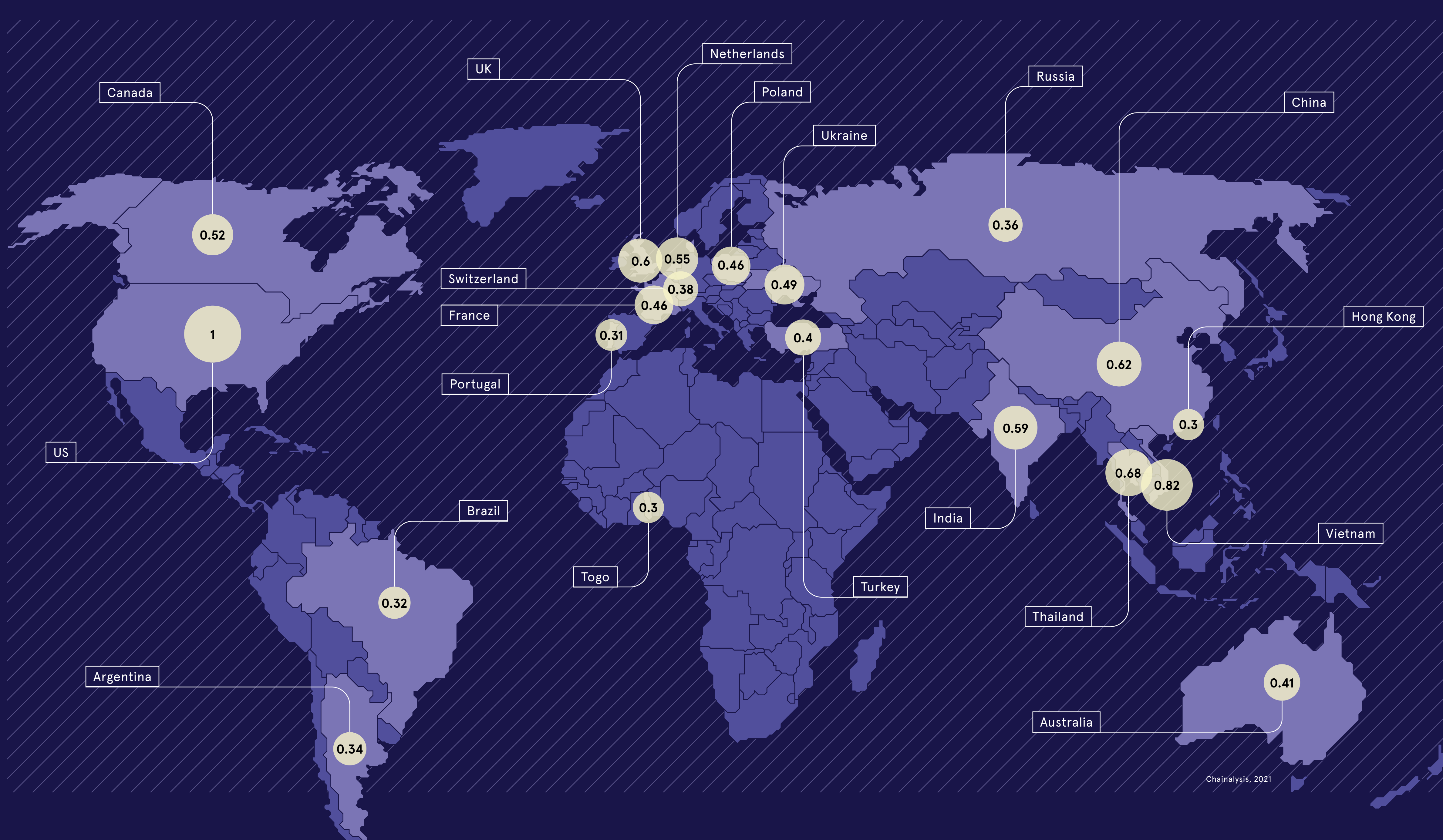
PAYING WITH CRYPTOCURRENCY

Willingness to use/accept crypto payments among customers/merchants across various industries worldwide



TERRITORIES WITH MOST ACTIVE DEFI INTERACTIONS

The 20 jurisdictions with the most DeFi platform interactions, as measured by their index scores between April 2019 and June 2021

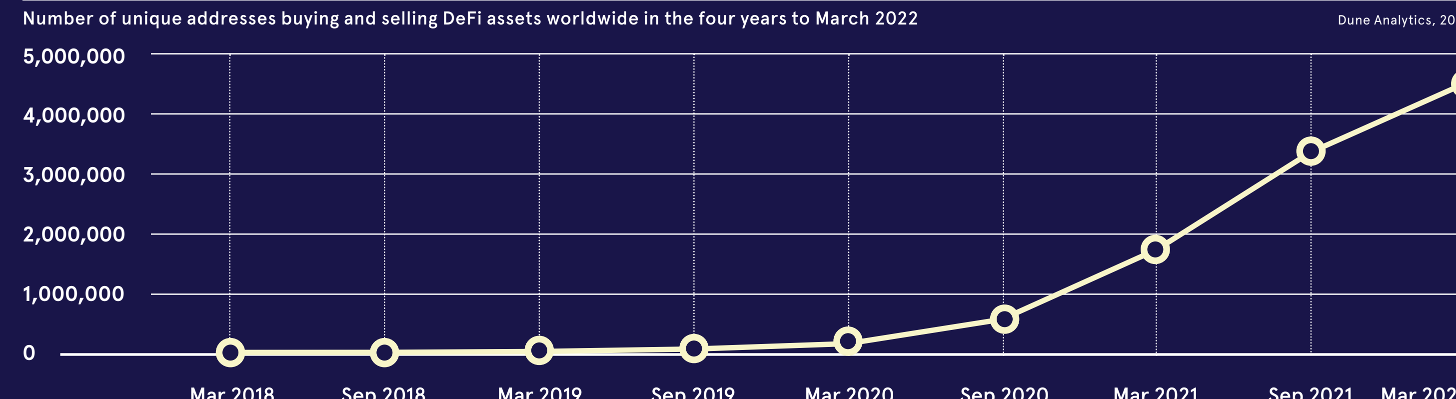


POPULAR DECENTRALISED EXCHANGES

Exchanges most used by crypto hedge funds worldwide in Q1 2021 (share of respondents)

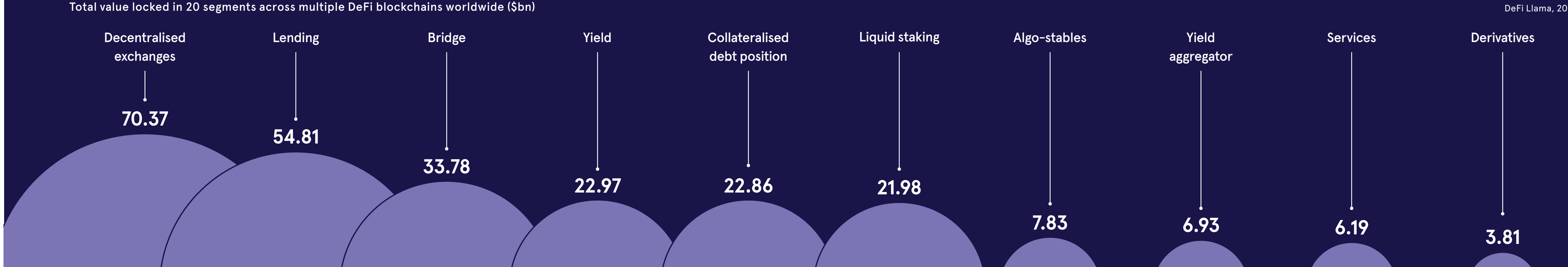
THE RISE OF DEFI TRADING

Number of unique addresses buying and selling DeFi assets worldwide in the four years to March 2022



DEFI USAGE ACROSS FINANCIAL MARKET SEGMENTS

Total value locked in 20 segments across multiple DeFi blockchains worldwide ($bn)



Commercial feature

Transforming lending through cloud services

Cloud technology is helping banks rethink their business models and making core functions such as lending more efficient while delivering a more personalised experience for their customers

As pressures mount on financial institutions to accelerate their digitisation efforts, many are moving their operations to the cloud. Yet what started out as a way to improve areas such as data and analytics is now being applied to their core banking systems; enabling banks to potentially transform their core business: how they lend.

About four in five banks plan to move at least half of their mainframe technology to the cloud, according to a survey published in April by Accenture. About a quarter of those aim to do so before the end of this year.

"When we started nCino in late 2011, customers were still evaluating whether the cloud was something that the financial services industry would move towards," says Charlie McIver, managing director for EMEA at nCino, a cloud-based banking software provider. "Today however, we see a rush to adopt. Financial institutions began to understand that if they've been delaying digital transformation, they can't continue to wait."

McIver says that even those banks that have started out on their cloud journey are now seeking to optimise and accelerate that adoption. "We are not spending a lot of time talking to the market about why banks need to move to the cloud; we're talking to them about how to move to the cloud, at speed, and to best effect," he adds.

This shift is helping banks streamline their business operations and make the lending process more efficient.

"The fundamentals of banking remain: lend money to create value," says McIver. "How banks accomplish this goal productively and profitably, however, is changing. Years ago, if you were a bank and wanted to get on the cloud to do lending, you would've had to potentially build something in-house. Now you can get a packaged offering with nCino and go live in months, not years."

Changing consumer habits

Customers also increasingly want to apply for loans online, a major turnaround from the pre-Covid era.

"Two months before the pandemic, borrowing money through the internet for a business was still a difficult experience," says McIver. "Fast forward a few months and banks were scrambling to rapidly create new digital systems for loans and funding, and the applications were submitted via mobile devices from people's living rooms."

Customer expectations have changed in line with the broader digitisation of their lives. Not only do they expect financial institutions to provide a faster, digital banking experience, but they also expect a more personalised service. By using cloud-based core banking tech, financial institutions can start to offer customers more bespoke loans as part of a wider relationship lending strategy, says McIver.

"Relationship lending is an increasingly effective strategy because it helps institutions develop a deep personal relationship with their customers, giving them the ability to guide customers through lending decisions and options that are specifically tailored to their individual needs," he says. "Financial institutions of all sizes are embracing relationship lending as an approach that provides the best of both worlds: customers receive personalised attention that offers better value, while bankers learn more about their customers' needs over the course of their lives."

That results in better lending decisions, which benefits both the customer and the bank, says McIver: "Rather than purely transactional, this approach is highly consultative, allowing financial institutions to build relationships with their customers that can last a lifetime."

Using cloud services for core banking can also help banks unlock a vast trove of previously untapped data and new partners to learn more about their business.

"As financial institutions continue their transformation journey, they are realising that having all that data in one place gives them opportunities within their market that they didn't know were there," McIver says. "It's given them a lot more transparency into how their institution is running and where they can go forward."

Digitisation drives profitability

Using cloud services to power core banking functions can help banks become more profitable.

"By rethinking their business models and embracing the cloud and other innovative strategies of digital-only banking and financial services, traditional banks could boost revenues by nearly 4% annually," says McIver.

That would result in more than half a trillion dollars in additional revenues by 2025, according to Accenture.

"Using automation, advanced analytics and other emerging technologies, banks have a real chance to increase business agility,

> Relationship lending is an increasingly effective strategy because it helps institutions develop a deep personal relationship with their customers

reduce costs and deliver enhanced customer and employee experiences," McIver says. "Customers want to interface with efficient systems that already have their information; they don't have the time or desire to repeat themselves while yet another banker rekeys their information."

Financial institutions that adopt state-of-the art cloud-based tech like the nCino Bank Operating System can solve that problem by consolidating data in one secure, central location rather than being siloed across multiple systems, as well as partnering with new third parties, improving the customer experience, says McIver: "This is just one example of how technology can be leveraged to help meet the needs of customers, so they don't have to go elsewhere to obtain specialised services and loans."

Digital transformation on its own, however, is no longer a differentiator for financial institutions. It is how they use that technology to create new products and services that will help them stand out. "Banks need to go beyond becoming mere digital versions of themselves and shift their perspective to put innovation, agility, purpose, and sustainability at the forefront of real business model transformation," McIver says.

Some financial institutions have been hesitant to fully embrace digital transformation, in part because they don't want to disrupt existing practices that have been successful. He adds: "Banks are understandably reluctant to discard systems and processes that still drive their profitability in the short-term, and it's difficult to take risks and make changes for an uncertain future."

Yet given the backdrop of rapidly changing business and economic conditions, financial institutions need to constantly adapt to improve operational performance and service quality for customers – and the only way to do that is through technology.

"At a time when banks are facing unprecedented competitive pressures, the cloud offers a means to respond forcefully," says McIver. "Banks are going all-in on the cloud because it gives them increased speed and agility, improved security and new capabilities that enable them to grow revenue regardless of what the future holds."

To find out more, please visit ncino.com

ncino

Q&A

ESG is not as easy as ABC

Steward Redqueen's ESG data and analytics manager **Claire Nooij** says that while the ESG industry is booming, banks face a major challenge to address ESG issues in their lending portfolios – and many are ill-equipped to do so

Q What are the main challenges banks face when trying to meet their ESG goals?

A Banks face three big challenges: addressing climate change in their lending portfolios, friction between long-term goal setting in a short-term focused society and maintaining their clientele amidst rising ESG demands.

The Bank of England recently made a 10-part pledge to advance the climate agenda. Making the financial system more resilient to climate-related financial risks and to help the industry support a transition to achieving net zero emissions are just a couple of the pledges made. Climate change forces banks to reconsider activities as part of their risk framework by asking different questions than they previously would have, such as what happens to the ability of clients to pay off their loans when they are hit by extreme droughts.

Financing the green transition is great, but what about the outstanding loans in industries that are infamous for being large emitters and that society heavily depends on? A bank might not want to give out such loans, but if we are dependent, parties jump in to finance it anyway and the world will not be better off.

Another challenge is the friction between committing to a long-term agenda in a short-term focused society. Considering the current pace of becoming net zero, 2050 is around the corner. From a bank's perspective it is ages away: at least a couple of CEO terms. With most CEOs not looking further than four to five years ahead, clear ownership to reach the end goal is lacking. At the same time, banks' clients and investors increasingly demand that they focus more on ESG, so it's also about making sure banks do not lose business by inadequately addressing ESG. The commitment seems to be there, but how do they go from conversations and goal setting to realisation? This is exactly where banks struggle.

Q How much focus should banks be placing on ESG?

A The science from the latest Intergovernmental Panel on Climate Change (IPCC) reports is clear: the costs of addressing climate change are huge. In light of that, banks will need to stop talking and start acting. This means allocating capacity to integrate ESG into policies, processes and performance reviews. Decision-making processes need to be recalibrated for meaningful change throughout the organisation.

Banks will also need to have a smart management system that tracks sustainability efforts and engagement with key stakeholders. Finally, it is important that ESG is integrated in the DNA of the bank: from procedures and policies all the way to the interaction they have with clients.

Q What should a good ESG strategy look like for a bank?

A First, given the broad array of ESG aspects one could consider and the subjective nature of ESG, it is important that a good ESG strategy has clearly formulated measurable goals that take into account client characteristics, regulations and external commitments, like the Paris Agreement.

Second, ESG commitments need to be put into practice by allocating employees, assigning responsibility and including ESG considerations in day-to-day activities, such as loan applications and client onboarding. Finally, banks need to track their progress on integrating ESG efforts so that they can improve their performance over time: after all, what gets measured gets managed.

> Banks need to track their progress on integrating ESG efforts so that they can improve their performance over time; what gets measured gets managed

Q In what ways can digital transformation help banks improve their ESG commitments?

A Banks, generally speaking, are dependent on legacy IT systems, which inhibit their ability to manage ESG across their services. Digital transformation and ESG tools enable banks to streamline processes, like loan applications, across the company. Standardised, digital processes for ESG management enable banks to track ESG performance on a client, portfolio and bank-wide level. Information from tracking ESG performance, in turn, can be used for reporting, client engagement and enhancing overall efficiency. Streamlining processes through one central system does not only help banks start small by setting an ESG standard, but it also enables banks to quickly scale up their ESG efforts and realise their ESG commitments.

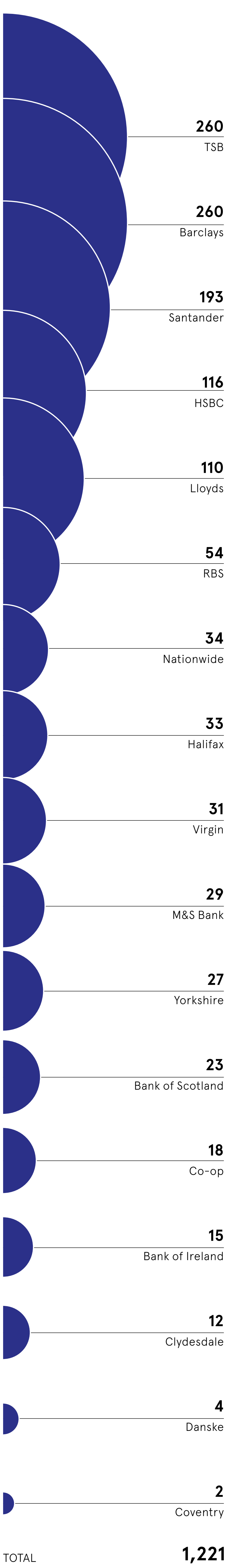
FINANCIAL INCLUSION

Olive branches: how to make amends with the high street

Communities nationwide are losing their banks, but there are ways to preserve the local facilities that millions of cash-dependent customers – many of whom are vulnerable – still sorely need

Daniel Thomas

BREAKDOWN OF BRANCH CLOSURES IN THE UK BETWEEN 2019 AND 2021



Which?, 2021

When the Royal Bank of Scotland announced in 2016 that it would be closing its branch in the town of Cambuslang, Lanarkshire, it started a chain reaction. Within 18 months, the town's two remaining bank branches – run by TSB and Clydesdale – also shut their doors. The growing popularity of digital banking was widely blamed for the decline in footfall that had made these sites unviable. Cambuslang duly joined the hundreds of communities across the UK that had become unbanked over the preceding decade.

For Cambuslang Community Council, a formally constituted group of residents who had been working to regenerate the area, it was a huge blow. Local people who'd depended on cash, many of whom were elderly and disabled, were "left stranded", recalls the group's chairman, John Bachtler, who is also professor of European policy studies at the University of Strathclyde. Many of them were no longer able to manage their money unaided, which meant that they became "dependent on carers or family members" or even ran up problem debts.

It was also bad for the entire high street, as many small shops suffered a serious decline in business. After the closures, there were two cash dispensers left in Cambuslang, one of which was regularly out of service. That not only made it more difficult for consumers to access and spend money in town. Traders also had nowhere to deposit their takings other than a post office counter inside a convenience store in a less-than-convenient location for many of them.

The story would have ended there but for Cambuslang Community Council's determination to tackle the problem. After writing to the banks' CEOs with little success, it learnt of a scheme called Community Access to Cash Pilots (CACP). This was an independent initiative backed by a range of stakeholders, including several banks, the Federation of Small Businesses and a consumer rights group called Fairer Finance.

The council applied to CACP and in 2019 received a grant to come up with a workable solution: a shared bank hub. This facility, located in an old butcher's shop in the centre of town, is run by the Post Office in partnership with Bank of Scotland, the Royal Bank of Scotland, Santander, TSB and Virgin Money.

From Monday to Friday, customers of any of these five banks can use the hub for basic transactions such as depositing cash and cheques, withdrawing money and paying bills. To deal with more complex matters such as loan applications, advisers from each bank come in once a week to meet customers in a private room.

The impact has been "phenomenal", according to Bachtler, who reports that the customer satisfaction ratings of the 500 or so people who use the facility each week range between 95% and 99%. He also believes that its creation has led to an increase in footfall in the town centre, encouraging new shops to open.

Is it a solution that can last? Bachtler accepts that the UK is moving towards a cashless society in which bank branches will have even less of a role, but adds that this will take at least 20 years.

"The idea that we don't need branches in the meantime is completely flawed," he argues.

According to research published in April by *Which?*, the magazine of the Consumers' Association, just under 4,700 of the UK's bank branches have shut their doors permanently since 2015. That's a decline of nearly 50%. It also identified 17 parliamentary constituencies where access to cash is "particularly poor", offering three or fewer branches and 30 or fewer cash dispensers that don't charge for withdrawals.

Despite this, *Which?* has estimated that 5 million people in this country still rely on cash. At the rate that bank branches are declining, those who depend on notes and coins risk being "cut adrift", it warns.

Shared banking hubs are only one way to deal with this problem. Startups, lenders, trade groups and charities are all working on concepts designed to keep in-person banking services alive. Yet they face a harsh reality, given that a further 226 branch closures are already known to be scheduled for this year alone.

"We have 18.6 million regular online banking customers and more than 15 million mobile app users. Fewer customers are choosing to visit our branches. We're like many other high-street businesses in that respect," says a spokeswoman for Lloyds Banking Group, which has closed scores of its branches over the past five years. "We have to respond to this changing behaviour."

Cat Farrow is lead coordinator of the Access to Cash Action Group at banking trade body UK Finance, which supported the CACP initiative. She believes that "there will always be a place for cash". For as long as digital banking "isn't a realistic choice for everyone, we're committed to maintaining access to it".

Farrow adds: "The biggest reason why people rely on cash is that they're on low incomes. Dealing in cash is still the most effective budgeting method for them. If someone has £6.30 to last them a few days, they may find the challenge easier if that's in cash. It can also be important in remote areas where the lack of a good phone signal can make it impossible to make digital payments."

The CACP scheme, which ended as planned in October 2021, trialled a range of solutions in eight underbanked communities around the UK. The shared banking hubs – which were piloted in Cambuslang and Rochford, Essex – attracted the most attention, with these two becoming permanent fixtures and five more set to open this year in towns ranging from Knaresborough, North Yorkshire down to Brixham, Devon.

"It's hardly a revolutionary concept, but the combination of having cash services at a counter and the ability to speak to someone from your own bank, all in a key high-street location, has proved incredibly popular," Farrow says. "More than £11.6m-worth of cash withdrawals and deposits took place in Cambuslang and Rochford during their banking hubs' first year of operation."

> **"The biggest reason why people rely on cash is that they're on low incomes. Dealing in cash is still the most effective budgeting method**

But the hubs do have their limitations. Some small businesses feel uneasy about depositing large sums of cash with them, for instance, and they are unlikely to be set up in small and/or remote communities. As such, they are seen as only one piece of the puzzle.

Other concepts that have been tested include a 'cashback without purchase' service run by bill payment network PayPoint in small shops, which has enabled people to check their account balances and/or withdraw cash without having to pay a fee or buy something. In light of a recent legislative change, 2,000-plus stores nationwide have made the service available and more are expected to follow.

A 'click-and-collect cashback' service has been trialled in Burslem, Staffordshire, while dedicated banking areas were set up in Co-op supermarkets where consumers and businesses could access their accounts with the help of trained staff. In addition, post offices that already offered banking services were refurbished to make them more suitable for larger cash transactions. Automated deposit machines were installed at some of these so that local entrepreneurs could bank their takings without having to queue.

It remains to be seen how many of these innovations catch on more widely, but they do indicate a willingness in the sector to reimagine branches by consolidation or outsourcing their services.

One of the prime movers in this respect has been the Post Office, which has been filling much of the void on the high street left by the banks' exodus. Since 2017, it has been handling basic deposits, withdrawals and balance enquiries for the customers of 30 banks and building societies via its banking framework agreement, which has just been renewed until 2025. The company's 11,500 branches nationwide are handling more than £3bn a month in cash transactions.

A spokesman for the Post Office says that it provides the only existing cash network in the country with "the scale of infrastructure, robust scalability and security" in place to manage this role in the cash market.

He adds: "In many places across the country, the Post Office is providing the last counter in town where people can access cash."

Does all this mean the end of the traditional bank branch as we know it? Not quite. Metro Bank has put branches at the heart of its bricks-and-clicks strategy and, despite some setbacks, the plan appears to be working. Established in 2010 after the global financial crisis, it was the first new high-street bank to open in the UK in more than a century. Its core aim was to provide excellent service at a time when public trust in the sector was at a low ebb.

As its rivals closed branches, Metro Bank opened them, seeing them as key to its "culture and brand". Today, it has 79 branches, although it's planning to close three this year.

"Many customers value face-to-face interactions for key moments, such as taking out a loan," says a spokeswoman for the bank, pointing out that branches are about more than merely protecting access to cash. "Our small business customers also benefit from a named local business manager who can help them in all sorts of ways."

That said, Metro Bank's sites are quite different from those of traditional branches, opening from early in the morning until later in the evenings and on weekends – times that are convenient to its predominantly younger retail customer base. Metro Bank branches, which it calls "stores", also offer features such as safety deposit boxes alongside more traditional counter services.

The bank says that there is a slight bias among older customers towards using its branches but adds that more than 60% of its current accounts are opened on site. "Customers can walk in without an appointment, open an account on the spot and leave with a debit card," the spokeswoman says.

The bank's expansion plans have been hit hard by the Covid crisis and its shares have not recovered since an accounting scandal in 2019, in which it erroneously classified a portfolio of commercial loans for capital purposes, thereby failing to hold enough capital to ensure its regulatory compliance.

That said, the business is still growing. It serves 2.5 million customers, up from 200,000 in 2013. In February, it opened its latest branch in Leicester, although it admits that it has no immediate plans for further openings.

The incumbents that Metro Bank is challenging have changed the branches they have retained, cutting staff numbers and using more automation. So says Tony Farnfield, a partner at BearingPoint, a tech consultancy that has helped Barclays to modernise its branch estate. He thinks that there is clear scope for banks to go further, although the main role of branches is likely to be advisory.

> **"It's hardly a revolutionary concept, but the combination of having cash services at a counter and the ability to speak to someone from your own bank, all in a key high-street location, has proved incredibly popular**

"It will be about helping people with complex borrowing decisions, where you want to see your customers face to face," Farnfield predicts.

Nonetheless, he agrees that branches can be key to a bank's brand and says that lenders are sometimes wrong to close certain sites. He cites work that BearingPoint did with telcos which found that even an unprofitable mobile phone shop could still be extremely good for "brand perception" if its footfall is high enough.

"We built an AI model that correlated sales and geolocational data. From it, we found that removing an unprofitable outlet would sometimes make no difference to the bottom line," Farnfield says. "So I think banks really have to be careful."

Back in Cambuslang, Bachtler says that he's been heartened by the success of the CACP experiment. But he fears that the wider situation is unlikely to improve unless Westminster gets behind initiatives such as shared bank hubs.

On 10 May, the government finally answered calls for it to protect the cash economy by law. In the Queen's Speech, it said it would legislate to ensure "continued access to withdrawal and deposit facilities across the UK" but gave no details. It remains to be seen whether regulators will be awarded powers to prevent banks from closing more branches. Currently, all they can do is issue guidance and share examples of good practice to dissuade them.

Another positive development is that big banks have signed a new voluntary agreement which means that an independent assessment of local needs will be conducted each time a branch is closed. Such a review could recommend that a shared branch is opened, a cash machine installed or a post office upgraded. The signatories say that they will commit to delivering whatever is recommended to ensure that vulnerable customers and cash-dependent businesses continue to have access to the services they need.

Farrow says that more pilots are on the cards. When it comes to the forthcoming law, she is keeping her fingers crossed.

"Although I don't know what the new legislation is likely to stipulate," she says, "we're hopeful that it will enable us to continue with the progress we've made so far in protecting access to cash in communities across the UK." ●

20%

The decline in the number of cash machines around the UK between July 2018 and February 2022

1.3

The number of bank and building society branches in the UK per 10,000 people as of 2021

House of Commons Library, 2022

How to prepare for the future of digital banking

Customer expectations are rapidly evolving in the financial sector, and to meet them, banks will need to develop highly personalised products and services

Although digital banking was accelerating before the COVID-19 pandemic, the events of the past two years have pushed the pedal firmly to the floor. Contactless payments are now the default option for millions of people. Chatbots and app-based banking have been embraced by more age groups, and new payment providers have caught the eye of consumers looking for financial flexibility and convenience.

Central bank digital currencies are also looming on the horizon. Meanwhile, so-called 'super apps', which bundle together financial services with numerous others, are beginning to make the jump from China and Southeast Asia to western nations. And let's not forget big tech's big push into the financial sector.

So how do banks fit into this rapidly developing digital landscape? Are they equipped to deliver the products, services and experiences that consumers want? And what are the key operational and technology challenges that will define their future?

KPMG is helping banks to answer these questions and develop the right technology strategies for success, alongside regulatory and risk strategies, in a highly digital world. One key finding is that banks will need to tap into the wealth of data that's available today to anticipate customer needs and provide highly personalised offerings.

"It will feel to the individual as if they are now being treated as one," says Paul Greenan customer and digital director for banking at KPMG. "And so it should, because their bank has so much data about them."

Unlocking this data could provide customers with the kind of insights and analysis that will help them make better financial decisions. "You move away from 'here's something you might want' to 'actually, you should take this course of action.'" Greenan explains.

Granted, this is already happening to a degree. But the recommendations many customers receive from their bank today are mostly broad brush rather than truly focused on their individual circumstances. So what's stopping banks from providing a more personalised service?

"There's certainly a greater degree of awareness around the criticality of customer experience and also the criticality of data to allow you to improve that experience," says Isabel Zisselsberger, head of strategy and operations for financial services at KPMG China. "[But] it's like moving an oil tanker: it's just hard work to unbundle architecture and years of product-centric thinking to become more client-centric. And even if you've got it nailed for your front office, you have to do it consistently throughout your organisation."

Personalised support

One financial services firm that has made serious headway on this issue is USAA, which took the top spot in the 2021 KPMG Customer Experience Excellence (CEE) report.

"Customers say the experience they deliver is the best they get anywhere – not just in banking but in every aspect of their lives," says David Conway, who co-manages KPMG Nunwood's customer experience management practice. "…They [USAA] are able to predict with something like an 80% level of certainty when a customer is about to go into a life event. And that means they can be present at the point in time when the customer needs help or support or signposting to things that might be useful to them."

This isn't altruism. Life events are triggers for buying financial products, so the bank is able to sell its offerings at the same time as providing help. But from the customer's perspective, the service they receive – and the relevance of the products they're offered – is second to none.

Such advanced approaches to customer segmentation, which focus primarily on uncovering unmet needs and intervening at opportune moments, are far from the norm today. For many banks, that's partly down to the limitations of their core platforms and technology stacks, which can be a major roadblock to meeting evolving customer needs.

"There are still a lot of silos within banks at a functional level, and data is trapped within those functions and then lines of business," says Celeste Diana, a principal in KPMG's financial services strategy practice in the US. "Banks need to have the right technologies in the right tech stack to unlock that data and make it commonly accessible."

As well as breaking down data silos within their own organisation, banks will need to ensure they have the right talent to deliver data-enhanced products and services. Data scientists, cybersecurity specialists and digital transformation experts will all have a crucial role to play in enabling data flows, implementing cloud-based solutions, and ultimately delivering the kind of digital banking services that customers want.

True personalisation of products and services will also require more data from partners and other sources. "If you're a small business owner, then it could be buying and selling activities that aren't necessarily transparent from your bank transactions but are from your Shopify or Amazon trading account," says Greenan. "That kind of data would allow the bank to really understand your business – perhaps that there's an element of seasonability, which creates a bit of risk that they can help you with."

Finding the right partner

Many partnerships in the digital economy will, of course, go beyond data sharing. To meet customer expectations in a rapid, agile way, banks may seek closer relationships with a variety of fintech or e-commerce firms, as well as innovating more with cloud providers. For example, if a fintech can help to streamline a certain process safely, at scale, there may be little point in the bank building that capability itself.

The rise of Banking-as-a-Service could also enable more mutually beneficial partnerships with non-banking firms that wish to offer their customers financial services and products. But to remain visible and relevant to customers, banks will need to strike the right balance between building things themselves and building an ecosystem of partnerships.

> **If the banks allow themselves to get into the position of just being an intermediary in a bigger ecosystem, they will lose valuable data points**

"Partnerships and alliances for me are absolutely critical, but it is about finding the right partner at the right point of the value chain," says Joe Cassidy, a partner and head of FS strategy for KPMG UK.

Get this wrong, and disintermediation becomes a real risk. "If the banks allow themselves to get into the position of just being an intermediary in a bigger ecosystem, they will lose valuable data points," says Zisselsberger. "They lose the ability to understand what… clients are looking for [next]."

One thing they do want is a bank that has clear values and purpose, and acts in an ethical, meaningful way. "Customers now are looking in a much more judgemental way at the organisations that they deal with," says Conway. "This started with millennials, but it has now moved up the demographics."

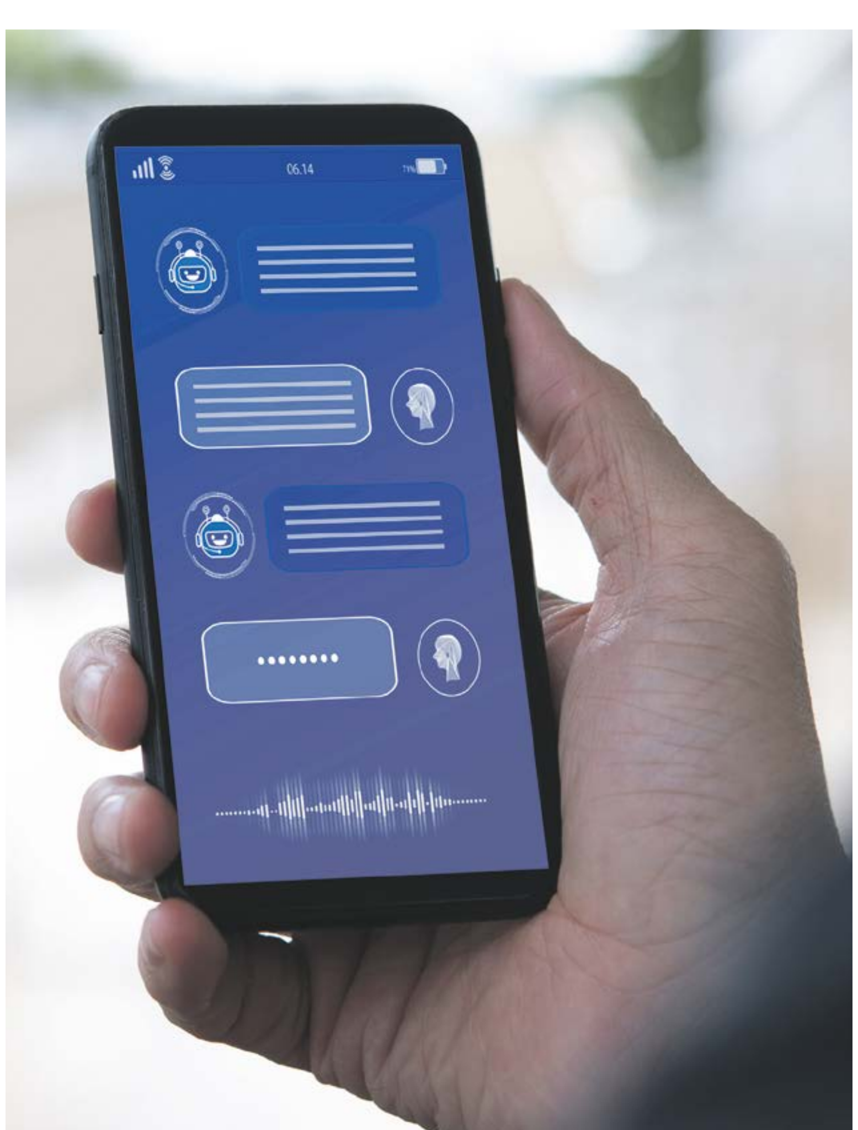
For example, people are more likely to discontinue their relationship with a bank because it's not meeting their sustainability values. "Increasingly, customer expectations of banks will be about more than just their carbon footprint. It'll be about the ecosystem of things that the bank interacts with and whether, societally and environmentally, it is using its power to drive good."

Data security is another issue that customers expect their bank to take a lead on. Firms are, of course, well aware of the importance of robust cybersecurity measures. But in an increasingly digital landscape, the stakes will be higher than ever before.

If they can't demonstrate that customer data is truly safe in their hands and used primarily for the customer's benefit, they may find customers are unwilling to share more of it with them – and that could be hugely detrimental to the bank's ability to provide truly personalised products and services.

Cassidy believes that banks must therefore strive to become true data custodians. "Without [customer] confidence in data – how it's being used and where it's being used – you can't actually build those distinctive propositions," he says. And ultimately, it's these distinctive, personalised propositions that will determine who thrives and who gets left behind when it comes to digital banking.

For more information please visit home.kpmg/uk/futureofbanking



Q&A

The future of customer experience

Paula Smith, partner and head of banking and capital markets at KPMG UK

Q How are customer expectations evolving in the financial sector?

A The challengers that have come in have raised the bar of customer experience, and they've now raised it for everybody. So whether you are a mainstream bank or a building society, you have to provide that great customer experience because that expectation is out there. But you have not got a greenfield site to work with. You've got the legacy of years of core banking platforms, and yet you've now got some – but not necessarily all – of your customer base wanting to interact with you in a hyper-digital way.

Q How might the financial landscape change over the next 5-10 years? Will the shift to cashless accelerate, for instance?

A Cash will still exist…and that's partly generational, and it's partly to do with the black economy (the unrecorded and untaxed portion of the economy). The other big thing that's going to happen in the next few years is that we're going to move into a completely different interest rate environment. We've been in a low interest rate environment since 2008, so there are individuals who have never known their mortgage to go up. It's just been on a downward trajectory.

The advent of digital and the ability to provide insight and information also creates an expectation on the customer side that there will be some sort of proactive engagement. They want early warnings. They want alerts. They want insight into the direction of travel and how it will impact their disposable income. Whereas before, it was a letter through the door that came too late [to be of use].

Q What tends to frustrate customers when they're interacting digitally? And will the option to speak to a human being remain important?

A Digital interaction is brilliant as long as it's brilliant. But any time you get below that level, you run into problems. If you have a fabulous website that's totally intuitive, you don't get customer frustration. But, if it's not highly intuitive, then you do get customer frustration, and people want to speak to a human being.

There is also a generational play here. Someone who is twenty may feel that speaking to a human being isn't necessarily that helpful. Whereas my default feeling is that if I can speak to someone, I can sort things out a lot quicker than I can through digital interaction.

Q How can partnerships with fintechs help to improve the customer experience?

A There are some clear use cases for fintechs that will really help banks – one being the movement of data. So any fintech that can help move data from one source to another – whether that's through open banking or whether that's from accountancy software – for the benefit of the customer, and which allows them to then manage that data and interact with it in a better way, could be really helpful.

Charlesdeluvio on Unsplash

HR STRATEGY

Gap analysis: a sector's scrabble for scarce skills

It saw the talent shortage coming and has started to respond, but the industry is struggling so far to solve a problem partly of its own making

Cath Everett

In January 2020, Mark Hoban, chair of the UK Financial Services Skills Commission (FSSC), warned that the industry was facing an "existential skills crisis".

At the time, the former employment minister was chairing the Financial Services Skills Taskforce, an independent body formed by the Treasury to explore how the UK could retain its world-leading status in the sector. It identified some key problems, including a lack of diversity (see panel, right) as well as the skills gap that Hoban highlighted, that were putting the nation's competitiveness in financial services at risk.

The FSSC was duly created in the spring of 2020 to tackle such challenges but, just over two years later, the industry still seems to be struggling. Recent research by Talent.com suggests that the gap between the number of vacancies and the number of trained professionals to fill them widened by 40% in 2021.

A key reason for this has been the combined impact of Brexit and Covid on international recruitment in a market that has traditionally relied heavily on foreign talent. But so is the fact that the pandemic has prompted many employers to start onshoring jobs, particularly tech-related ones, to address concerns about security and operational resilience.

That's the view of Claire Tunley, the FSSC's chief executive, who notes that another Covid-related problem is that older employees have been leaving the industry at a higher rate than normal.

Moreover, wage inflation brought about by the sector's deepening labour shortage has been fuelling an increase in staff turnover, which is further exacerbating the situation.

Last year, 92% of the FSSC's member companies were struggling to fill job vacancies, according to its March research report, *Mind the Gaps – skills for the future of financial services 2022*.

This document also reveals that the industry is particularly lacking in five key skills. Three of these are technical: digital literacy, which needs to be developed across the entire workforce; and more specialised expertise in the form of data analytics and software development. The other two are 'soft' skills – coaching and creative thinking – that the FSSC deems crucial in aiding innovative problem-solving and staff retention.

> **"With 1 million people working in UK financial services, you cannot turn over the entire workforce**

But Dennis Khoo, the author of *Driving Digital Transformation: lessons from building the first Asean digital bank*, thinks that process design skills should be added to the list.

"You can't apply technology effectively unless you have good processes underneath," he says. "Understanding how processes support outcomes is paramount."

Whether the FSSC would agree with Khoo's assessment or not, it is widely accepted that the key factors behind all these skills gaps are, as Tunley says, "technological change and digitalisation because of how people are engaging with financial services, particularly since the pandemic started. This is producing more data, which creates a need for more analytics, which in turn leads to more digital products and services. And so it goes on."

In banking, there is another problematic factor, according to Simi Dubb, director of colleague experience and inclusion at Metro Bank. She says that the ongoing closure of branches has meant that customers are expecting more from their online banking services at a time when competition for digital skills on the wider market is already fierce.

As a result, "we've all had to put on data, digital and customer lenses when looking at roles, because the future of banking will be less about traditional relationship management and more about predicting what self-service digital products and services customers will need", Dubb says. "This is where the idea of reskilling and upskilling comes in."

Her view is shared by the FSSC. It believes that, given the significant shift in the types of skills required, the industry cannot solve its shortage simply through recruitment alone.

Tunley notes that the industry was failing before the pandemic to offer people much training beyond core areas such as regulatory compliance. As a result, it has fallen behind other sectors at a time when intense competition for digital skills in particular is starting to become a "blocker" to innovation and growth.

To ram home the point about the need for more training, the FSSC published a report at the start of this year entitled *Reskilling: a business case for financial services organisations*. This paper indicated that companies could achieve cost savings of up to £49,100 per head by retraining redundancy-threatened employees for new roles that would have required external recruitment. Despite this compelling business case, the industry has tended to make redundances and hire anew, rather than retain and retrain.

"With 1 million people working in UK financial services, you cannot turn over the entire workforce," Tunley says. "About 80% of the industry's current workforce will still be in employment in 2030. Given that only 20% will be new joiners, employers will have to retrain existing staff to obtain all the new skills required."

In other words, the profession's foundational skills are no less valuable than they ever were. They "just need enhancing if you want to add new digital services", says Tunley, who adds: "If you only recruit externally, you don't get all the knowledge you need in terms of internal processes. It's why you need both approaches."

Tunley acknowledges that retraining won't offer a quick fix, since it requires a "clear, well-structured plan and a long-term commitment". Nonetheless, she believes that meaningful change is afoot.

"We said a couple of years ago that there was an existential crisis and the industry had to act – and it is starting to," she says. "Although it's too early to say what impact that's having, things are moving in the right direction." ●

HOW FIRMS IDENTIFY SKILLS GAPS

Divisional feedback regarding growth areas	88%
Seek insight from HR (business partner models)	76%
Talent assessment data	65%
Employee opinion surveys	47%
Learning needs analysis process	47%
Strategic workforce planning tools	47%
Client feedback	24%

Financial Services Skills Commission, 2022

How to improve diversity, equity and inclusion

One approach to solving the skills shortage in financial services is for employers to seek talent from pools they haven't traditionally trawled.

Nearly 80% of workers in the sector are white, according to the Financial Services Culture Board (FSCB), an industry body formed from the Banking Standards Board in April 2021. Although data from the Office for National Statistics suggest that only 14.4% of people in the UK are members of an ethnic minority, the percentage rises steeply in cities. In London, for instance, it's closer to 40%. This means that financial services firms are often failing to reflect the diversity of communities in the urban areas where they tend to operate.

"When we asked them what could be done about this, they suggested: 'Hire more diverse people and ensure that there are more staff who look like me,'" reports the FSCB's senior analyst for assessment and insights, Pollyanna Wardrop.

But the industry also faces other, less immediately obvious, challenges concerning its lack of diversity, equity and inclusivity. For instance, although women comprise 52% of the UK's total financial services workforce, the proportion of senior managers who are white women is only 29%. Meanwhile, women from ethnic minorities occupy 6.5% of operational roles but a mere 2.7% of senior management jobs.

Even Metro Bank, where 45% of employees come from ethnic minority communities, acknowledges that they aren't nearly so well represented in the organisation's upper echelons.

This situation tends to be down to shifts at key "life transition points", such as child-rearing, according to Simi Dubb, the bank's director of colleague experience and inclusion.

"The challenge is to ensure that we have the right infrastructure and inclusive culture to support people through these transitions. We also need to reskill them continually so they can progress in their careers", she says. Doing so is vital not only to ensure that "diverse talent has an opportunity to thrive", but also to aid staff retention.

Kate Coombs, the FSCB's head of insights, agrees. The board's research has found that female employees from ethnic minorities feel less included than respondents in any other category, she reports, adding that literature from London Business School indicates that people's sense of belonging to their employer – or the lack thereof – is a predictor of its staff turnover rates.

"Also, the anticipation of belonging indicates a willingness on the part of a potential candidate to apply," Coombs says. "From there, you can extrapolate its importance to the hiring pipeline."

Just as vital is that people feel that they're being listened to, she notes. This is "super-important to enable culture change". Also, "listening and 'psychological safety' – whereby line managers create a constructive, sharing environment – are highly correlated".

All these factors put pressure on line managers to step up their games. Coombs believes that this will require "a shift at all levels in how they are trained, developed and supported. It will entail a lot of investment, because you cannot simply assume that they'll muddle through."

Commercial feature

Integration holds banks back from digital transformation

In the race to keep up with the rapid innovation of fintech startups, traditional financial institutions are running into integration challenges on their digital transformation journey

The rapid ascent of fintechs startups took almost every incumbent financial institution by surprise. Initially dismissing these upstarts as little threat to their long-held customer bases, legacy banks thought they could keep up with evolving consumer expectations through incremental changes and some new digital assets like mobile banking.

But by tuning into exactly what people want from banks in the digital age, fintechs have stolen customers from incumbents at a rate that few in the industry could have predicted. Personalisation has rewritten the rules of banking. Whereas previously consumers generally desired a one-stop shop of financial services from one or two major banks, now they are more likely to select whichever firm offers the best digital experience for each respective product.

"Fintechs not only provide their customers with a financial service but also personalise the experience to their satisfaction and new expectations," says Allen Terleto, field CTO at next-generation data platform company Redis. "While traditional institutions focus on cross-selling across a portfolio of products, a fintech's entire existence is often to serve its customers in just one domain. This specialisation and hyper-focus gives them a competitive edge over traditional banks weighed down by their massive operational scale and the inherent risks of transformation."

With so many fintechs zeroing in meticulously on the individual domains that form part of what a large bank offers, collectively they have become a major threat to the large financial institutions which have dominated the sector for decades. Seeing they were not digitally transforming fast enough to compete with the kind of innovation concocted at cloud-native, agile startups, banking execs have had to make big decisions on how to remain relevant.

Some have opted to replicate the fintech model by building innovative startup entities within their organisations, giving them the right people, processes and technologies to compete. Others have sought to fast-track digital transformation by acquiring startups. Having initially ignored them, banks are now forced to engage with the fintechs as peers.

Whether they are spinning out new digital assets through their own startup entities, or through acquisition, financial institutions are now seeking to evolve into technology companies. However, this poses major challenges, particularly when it comes to integration.

"Let's say a bank acquires a new fintech that is cloud native and provides a great personalised experience," says Terleto. "But the bank's entire portfolio still operates on-premises centered around a mainframe. How does it enable cross-functionally, cross-selling opportunities, or a unified customer experience?

"The last thing it wants is for existing customers to register with the new service siloed from the rest of the portfolio and serve as a constant reminder of the contrast between their experiences. To avoid this, the cloud-native technology stack, skills and agile processes must align and integrate with the legacy operations of the existing architecture."

Redis Enterprise, an in-memory NoSQL database platform, enables banks to overcome these integration challenges and digitally transform at a greater speed. A traditional financial institution whose operations are still mostly on-premise but which wants, for instance, real-time performance in its middleware can use Redis Enterprise to deploy on top of its private cloud, virtual machines or even bare metal without any impact on core operations.

If the same institution acquires a fintech startup that is based in the cloud with end-to-end real-time performance, and it wants access to that information on-premise and without losing any of the benefits of its cloud-native capability, Redis also facilitates that integration.

"For an integrated experience across the product portfolio, banks can create a hybrid deployment model between their on-premise operations and the cloud with active-active replicated Redis databases," Terleto says. "In this model, banks can match fintechs in time-to-market and business agility, without compromising and adding risk to their existing on-premises operations.

"It's the best of both worlds and creates an on-ramp for institutions that have near-term plans to progress along their cloud journey. They can migrate at their own pace in alignment with their governance, risk and compliance policies, and risk appetite."

For more information, visit redis.com

redis

REGULATION

Financial services industry braces itself for ‘seismic change’

The Financial Conduct Authority is finalising a new set of consumer protection measures that could prove a shock to the system for several businesses

Jeff Salway

When the UK’s Financial Conduct Authority (FCA) confirmed in late 2021 that it would be introducing its so-called consumer duty, there was little resistance from the firms it would affect. Perhaps this was because they considered it an inconsequential development that would have little impact on how they did business. Yet the measure – proposed in 2017 by the FCA’s Financial Services Consumer Panel – represents the widest-ranging set of reforms overseen by the regulator since it was established in 2013.

Its core requirement for companies to “focus on supporting and empowering their customers to make good financial decisions” sounds simple – and most will argue that they already do this. But the ambition behind this change becomes evident if you drill down a little further.

Joanne Owens is a partner specialising in the regulation of retail financial services at law firm Eversheds Sutherland. She believes that the consumer duty is a “seismic change” and “arguably the most significant shake-up of FCA regulation since the introduction of the Financial Services and Markets Act 2000”.

Of the 11 “principles for business” in the current *FCA Handbook*, the sixth obliges firms to “pay due regard to the interests of customers and treat them fairly”, while the seventh requires them to “pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading”.

The consumer duty will replace these with a single principle that applies higher standards: “A firm must act to deliver good outcomes for retail customers.”

The four key outcomes are: customers are equipped to make informed decisions; products and services are fit for purpose; services meet customer needs; and products and services represent fair value.

James Daley is MD of consumer rights group Fairer Finance. He also views the FCA’s planned reforms as a “sea change” that obliges companies to “prove on an ongoing basis that they’re delivering good outcomes for their customers. It could stimulate a race to the top on quality.”

The FCA expects the consumer duty to be fully implemented by 30 April 2023, so the industry must move quickly, according to Owens. She adds: “No doubt, the whole retail financial services sector is working hard on initial assessments and a gap analysis to understand where the current delta is between existing policies and procedures and the new standards.”

This is no mean feat, given the duty’s wide scope and application to all products. The rules make it clear that firms cannot continue with business models that rely on poor outcomes. This places certain products under threat. For example, 0% no-fee credit cards rely on some customers not clearing their balance and paying higher interest charges as a result. Similarly, it will be harder to justify leaving mortgage customers on high standard variable rates.

The extent to which customer choice might diminish because of the reforms will hinge partly on how firms judge whether they can still offer value for money. So says Neil Mitchell, head of customer risk at TSB Bank, who notes that there could be “a lack of consistency in approach”.

Price increases might be necessary to cover the costs of implementing the duty. The FCA has estimated the one-off direct costs at up to £2.4bn and ongoing annual direct costs ranging from £74m to £176m. Firms might change how they value products, as their prices must be proportionate to the overall benefit to the consumer.

“This is about assessing not just financial costs, but other non-financial costs to the consumer, including the use of their data,” Owens says. “That could have an impact on the length of distribution chains for some introduced products, particularly where a commission is charged.”

The scale of the challenge means that some companies will treat the consumer duty as a threat – although others will see opportunities, she adds. “This is a chance for businesses to shape and define their offerings and to think about how they deliver the right outcomes for existing and future customers.”

Mitchell reports that TSB established a programme in January to comply with the new duty. “We’re assessing all business units on their current position against the consultation and draft rules – this is our discovery phase. Once the rules are finalised, we’ll move to delivery.”

Much of the initial work by firms focuses on communications. Providers often write their terms and conditions through the lens of compliance – if the FCA signs them off, that’s good enough. But the duty will require them to ensure that customers can comprehend what they’re being told.

“The ‘customer understanding’ outcome means that they will have to understand communications – and we know that people can’t make head or tail of the Ts & Cs,” Daley says. “We’ve been helping companies to rewrite their communications for years, but we’re seeing a spike in interest.”

Banks will need to deal with the tension between the ‘customer understanding’ outcome and the consumer credit rules that require them to include prescribed statements in their communications.

The duty’s cross-cutting nature gives it the potential to catalyse cultural change across the industry. It may transform what retail products are marketed, whom they’re aimed at and how they’re sold.

From a regulatory perspective, the key desired outcome is a more stable market that needs less intervention and fewer rule changes. From a consumer rights perspective, Daley hopes that the changes will help to “improve standards and the quality of financial services over time”.

Given that the finalised duty is due to be published this July and full compliance is expected before May next year, there is little time for companies to waste in upping their game. ●

Robert Evans / Alamy Stock Photo

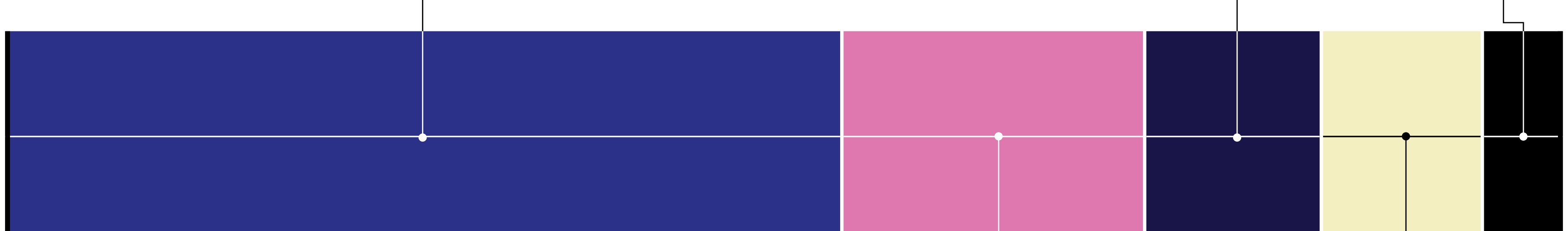
> This is arguably the most significant shake-up since the Financial Services and Markets Act 2000

£2.4bn

the implementation cost of the consumer duty, as estimated by the FCA

FTAdviser, 2022

UK CONSUMERS’ RESPONSES WHEN ASKED: WHAT FACTOR IS MOST IMPORTANT TO YOU WHEN YOU THINK OF YOUR BANK?



Owing to rounding, percentages do not total 100

Statista, 2021

Commercial feature

Banks tread the path to digital first

With banks increasingly turning into technology firms in their own right, Acuity Knowledge Partners CEO **Rob King** explores whether technology alone can ready them for the future

Data is at the core of banks’ transformation agenda. Global internet usage will generate hundreds of trillions of gigabytes of new data over the next few years. With unstructured data contributing more than 50% of the total, banks need state-of-the-art systems and talented data scientists and technologists to create AI and machine learning solutions that deliver value and produce a return on investment.

No CEO is isolated from these changes. In addition to unlocking the value of their data, bank CEOs are striving to build resilient yet profitable businesses for the future while tackling challenges such as the global pandemic, rising interest rates, changing consumer sentiment and geopolitical developments.

For consumers, the pressure to integrate digital in every facet of banking has transformed the notion of what a bank is. As markets like the UK move ever faster towards a cashless society and businesses embrace account-to-account processes, this only becomes more apparent.

Whether wholesale or retail, relationship management remains a core focus. Embracing a digital-first approach has shifted banks from fragmented fixes in siloed areas to organisation-wide digital transformation programmes to meet the evolving needs of customers, employees and regulators.

Today’s lenders are often as concerned with speed and code as with cash. According to a 2021 J. P. Morgan report, 13 of the world’s major banks are estimated to have spent $74bn (£59bn) on IT in 2020. Banks have arguably transformed into technology companies whose main business is routing, managing and controlling money.

Some 90% of senior decision-makers in corporate and commercial banks see managing credit risk efficiently as a top priority, according to a recent survey by Acuity Knowledge Partners, followed by compliance and improving internal digital infrastructure. Digitisation is an opportunity to improve the customer experience and reduce underwriting and monitoring costs, while simultaneously achieving better risk governance processes and boosting employee morale.

Most banks are adopting new loan management approaches to upgrade their old non-interactive systems to tackle underwriting and monitoring costs. Those ahead of the curve are adding AI and machine learning capabilities to automate the underwriting process.

Reducing compliance costs while improving operational efficiency is one of the major challenges banks are focused on. For example, most banks are trying to harmonise their fragmented data across compliance functions. This includes marrying human intelligence with technology to move away from manual, effort-intensive processes for ‘know your customer’ practices and alert investigations.

To meet these challenges, banks are tapping the potential of advanced technology. Innovations such as robotic process automation, blockchain and AI-driven verification enable them to work and comply with regulations more efficiently. This saves time and cost, while providing customers with access to systems that are intuitive and which seamlessly enhance the user journey.

The extra work burden, however, along with broader workforce trends driving the so-called ‘great resignation’, is putting a significant strain on core bank employees. The front office, credit risk, credit admin, data science and technology teams are grappling with attrition, making it incredibly difficult for banks to stay focused on their transformation agenda.

This is where strategic partners have a significant role in providing quality staffing to manage the human capital challenge while bringing in the required domain and process expertise, all at significantly lower costs. Banks today are on the lookout for strong data science, technology, and knowledge partners that can help them holistically on their transformation agenda.

The key to successful digital transformation lies in integrating technology and domain expertise. As enterprises recognise the benefits delivered by strategic partners with distinctive domain expertise, it becomes easier to scale innovation and digitalisation as they seamlessly support these initiatives without stressing the front office teams in running the engine. The changes banks are making are structural, technological, cultural and, above all else, vital.

Acuity Knowledge Partners is a leading provider of research, analytics and bespoke technology solutions to the financial services sector. For more information, visit acuitykp.com

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INSIGHT

‘The word “frictionless” is overused. What people are really after is the right friction’

A Q&A with **Nick Holland**, global head of research at Money 20/20, on innovation and user experience in the banking industry

Q What’s driving innovation and the adoption of technology in the industry?

A In recent years, there have been big moves to open the banking industry to third parties. There have been some regulations – in the EU, for instance – that have required banks to open their application programming interfaces to fintech firms and other participants, but there have also been obvious opportunities from a user experience (UX) perspective. A lot of banks had become fairly complacent with the tech stacks they had and didn’t think there would be changes any time soon.

Challenger banks have had a greenfield opportunity to reinvent some aspects of banking. Those firms were digital first, so they were able to consider UX from a different starting point, unencumbered by analogue processes. Think of opening an account: with a challenger bank it takes only a few clicks, while with a traditional bank it may be 100 clicks and you still have to visit a branch and bring a government ID document and a utility bill. Challengers have clearly upped the ante for what a good UX should be.

Of course, there has also been a pandemic, which made it necessary to serve a largely remote customer base. This produced an environment that was ripe for innovation. It probably moved the needle by a decade for services such as contactless payments and digital wallets.

Q What does a better customer experience look like?

A You’ll hear the word ‘frictionless’ being thrown around a lot in this industry, but I think that it’s overused. What people are really after is the right friction. Customers are trusting these entities with their money. They want to be sure that the guardrails are in place and that there are checks and balances concerning fraud and identification.

Some technologies – behavioural biometrics and cellular telemetry, for instance – create a veneer that seems frictionless from the customer’s perspective. But on the back end there’s a lot of due diligence going on to ensure that you are who you say you are.

There are now issues concerning the structure of identification. You probably have more than 100 digital accounts if you think about it and, unless you are using a password manager, you probably don’t have a unique, secure password for each one of them. This will increasingly be a fundamental component of the UX. An opportunity exists for identity to be managed in a centralised manner and in a way where the consumer owns it, whether that be through a state-issued digital ID or through a third-party provider.

Q What will be the industry’s most important technological advance in the medium term?

A Smartphones are still underutilised and there is huge potential to do something as simple as refining mobile banking app services and making them more accessible. They’re a massive part of the banking ecosystem in places such as Africa and other emerging markets that have traditionally been unbanked. But even in the US a significant proportion of the population is either unbanked or underbanked.

It may seem as though the more exciting stuff is decentralised finance, blockchain and all the capabilities around Web3, but there are several institutional factors holding these innovations back. Decentralisation is all about cutting out the middleman. But, if you’re a company that deals in remittances, say, decentralisation has the potential to kill your business model. Powerful incumbents – and that includes governments – will be reluctant to open the spigots too much on anything that could threaten their business models.

Cellular networks and the capabilities of mobile phones are therefore still mission-critical in banking. There’s a huge opportunity to create financial independence for people who have disconnected from the industry. ●

Nick Holland
Global head of research
Money 20/20

INTERVIEW

‘We want to be a bigger part of the conversation’

Ethical banks such as Triodos Bank UK are flourishing as consumers demand greater transparency from the sector. Its CEO, **Bevis Watts**, hopes that this will prompt the wider industry to reflect on its behaviour

Oliver Balch

Triodos Bank UK is the nation’s most important bank that most people haven’t heard of. With just shy of 85,000 customers, it’s very far from the biggest. Nor is it rich: its 2021 profit of £7.8m would barely cover the reward package of a high-street bank’s CEO.

Yet this Bristol-based challenger, the embodiment of an upsurge in consumer demand for ethical banking, is making the incumbents look like dinosaurs – and not the peaceable herbivorous kind. Since its establishment in 1995, it has become a star player in a national “ethical money sector” that the Ethical Consumer Research Association valued at £41.1bn before Covid.

If scandals such as the Panama, Paradise and Pandora papers hadn’t already done enough to highlight the less-than-ethical actions of many large financial institutions, the recent freezing of billions of pounds in Russian oligarchs’ UK bank accounts has rammed the point home. So says Dr Bevis Watts, CEO of the business, which is a subsidiary of 42-year-old Dutch plc Triodos Bank.

“The train had already left the station before the Ukraine conflict,” he notes. “It is good that all this stuff is being exposed, because now we can have a proper public debate about where our money should sit and how it should be used.”

By Watts’ own admission, ‘ethical banking’ is a woolly term (he prefers ‘sustainable’). It can range from a ban on financing ethically dubious industries to the active support of low-carbon enterprises, but one common factor is the notion that “money is not neutral”, to use one of his favourite phrases. Banks’ choices about whom they accept money from and how they use those funds have profound implications – for the environment, for democracy and for everyday customers.

Consider Triodos Bank UK’s loan book, for instance. Included in last year’s £1.13bn deal list is a roll-out of charging points for electric cars at British supermarkets; the UK’s inaugural inter-city all-electric coach service (between Edinburgh and Dundee); and its first ever net-zero housing development for private sale.

Compare that with the £13bn invested by the nation’s five largest banks – HSBC, Barclays, Lloyds Banking Group, NatWest Group and Standard Chartered – in carbon-intensive oil and gas projects last year, according to research conducted by the ShareAction charity.

This contrast points to another principle that Triodos and its ethical banking peers share: the need to balance the immediate interests of their customers against the longer-term welfare of the environment and wider society. If that sounds a little tree-huggy, that’s because it is, but it also makes commercial sense, Watts stresses. His argument in a nutshell: “What is the point of saving for a pension if you’re creating a world that you won’t want to live in?”

The Triodos philosophy is catching on: more and more banks with explicit ethical and/or ecological mandates are entering the market. Many belong to the Global Alliance for Banking on Values, an independent network that has 66 members with more than £160bn-worth of assets under management. The growth of this segment is no accident. Public attitudes are certainly changing, but successful marketing campaigns such as Switch It and Bank.Green have also given consumers the impetus to change their banks.

> **“What is the point of saving for a pension if you’re creating a world that you won’t want to live in?**

In an industry awash with ethical claims and counter-claims, how can people be sure that Triodos is the real deal?

It’s easy, Watts says: visit the Triodos website and call it up. Information on every loan the bank issues, every investment it makes and every policy it follows is in the public domain for all to see.

Such radical transparency not only contrasts with the opaqueness of most conventional banks; it also eradicates the “completely helpless” feeling that many people experience when they consider how a bank might be using their money, he argues, adding: “The level of transparency we provide really brings home the power you can have in knowing where your money is going.”

Watts points to the bank’s mobile app, which has a GPS-based location system that highlights any loans that Triodos has issued to customers in the user’s vicinity.

Such openness is not a one-way arrangement either. On the asset management side of its business, the bank is constantly demanding information from its investees. Watts estimates that “only about 25% of investors in the asset management industry are active. The rest are passive. Active investors will actually engage with companies’ management teams and scrutinise them on the promises they make.”

He would like to see all other UK banks follow Triodos’s lead in publishing the basic details of all their new loans and investments “as a minimum”.

Is there any evidence that the burgeoning ethical banking market has started to change how the whole industry operates?

Just because his cheque book is relatively small, it doesn’t mean that Watts and other advocates of sustainable finance have no influence on the wider sector. While he freely admits that “we aren’t going be the equivalent of one of the big four”, he says that a “big part of challenging the wider sector is to change how it thinks and operates. We want to be a bigger part of the conversation, which we’ve successfully achieved in recent years.”

One example of this has been the bank’s involvement in discussions in Brussels about the so-called EU sustainable finance taxonomy – in essence, a rulebook defining what products and practices can be classified as environmental, social and governance (ESG) investments.

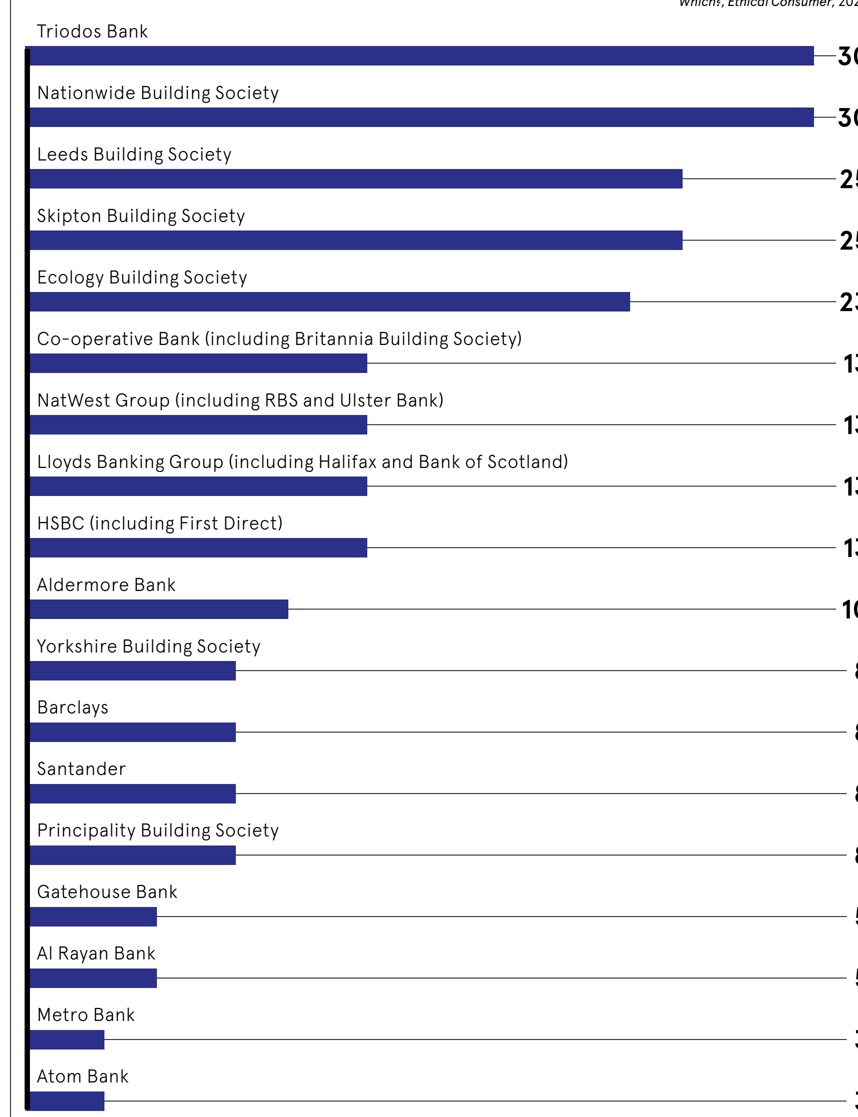
Watts can cite numerous small victories for ethical banking, such as the UK government’s pledge last November to oblige all large financial institutions to adopt net-zero emissions strategies.

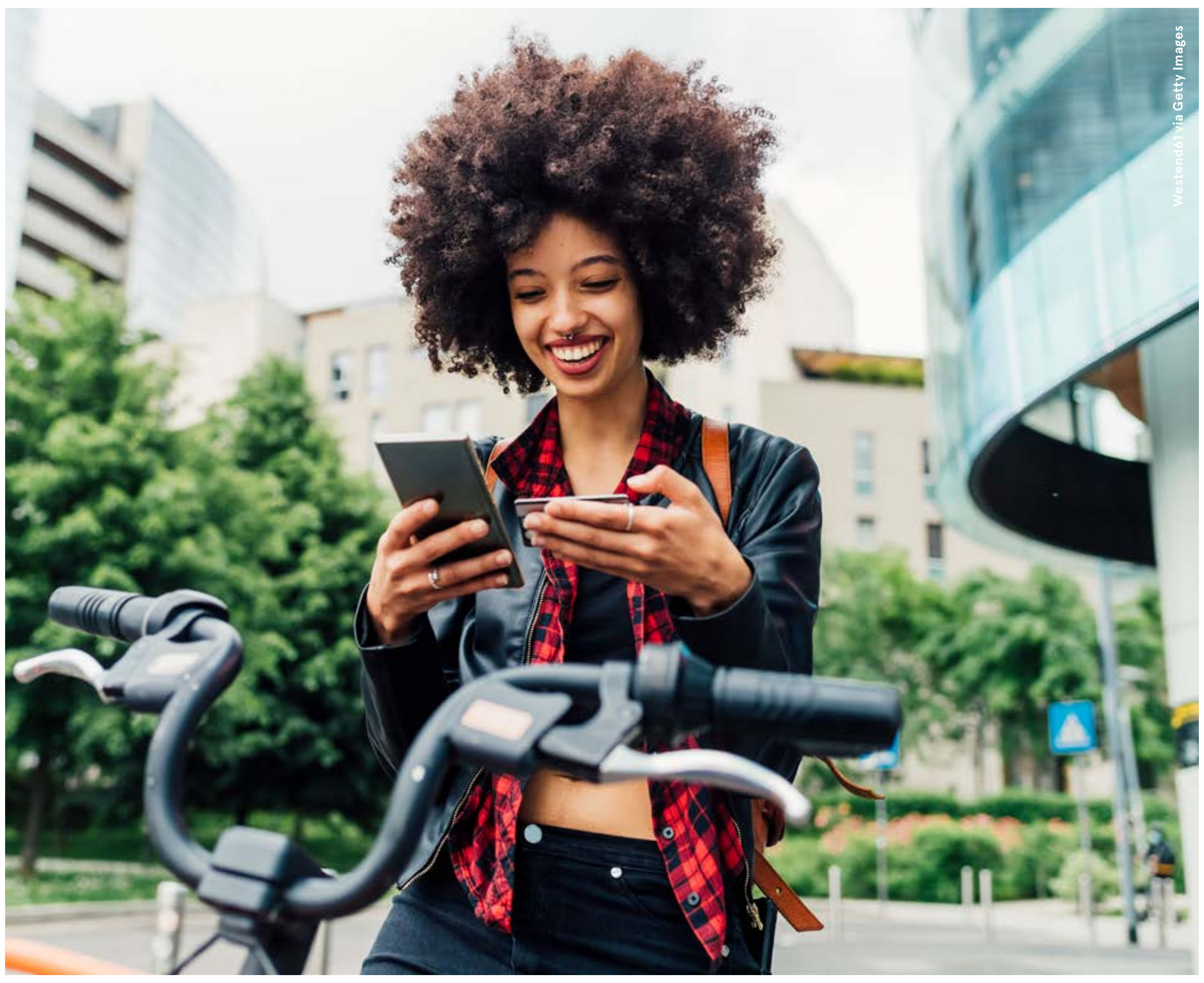
The banking industry has tended to be slow to clean up its act unless compelled to do so. Nonetheless, Watts is confident that further positive changes will come. Why? For the “plain and simple” reason that any bank focused purely on short-term profit is sure to suffer in the longer term as the effects of climate change and environmental degradation worsen.

As he warns: “Unless you’re thinking now about whom you’re financing and whether they’re resilient, I think you’ll be in for a tough time.” ●

TRANSPARENCY AND ETHICAL LENDING PERFORMANCE OF SELECTED UK BANKS (INDEX SCORE OUT OF 30)

Which?, Ethical Consumer, 2021




Westend61 via Getty Images

TECHNOLOGY

How open banking is helping consumers to live more sustainably

Customers, both personal and commercial, need support in making more environmentally responsible choices. The sharing of payment data could prove key to providing such assistance

Tom Ritchie

French carbon-tracking service Greenly has estimated that the average European is responsible for 15 tonnes of CO_2 emissions a year. To meet the EU's net-zero goal, that figure needs to fall to 3.5 tonnes by 2050.

Open banking could be useful in help achieve this goal, as it allows third-party apps to access payments and subscription data. This enables financial service providers and fintech firms to collaborate on innovative sustainability products.

Tasha Chouhan is banking and lending lead in the UK and Ireland for Tink, an open banking platform based in Sweden. She notes that current accounts "are a vast source of information. A huge amount can be derived even from one transaction. By aggregating, categorising and analysing transactions, open banking lets us create meaning from data to help people make informed decisions about sustainability."

Research by Tink has found that 53% of 18- to 34-year-olds want their financial services provider to actively help them mitigate their environmental impact. Nearly a quarter (23%) of respondents are already using mobile apps to record their carbon footprints.

NatWest is one bank that's introduced a carbon-tracking facility in its app for retail banking customers. Developed with the help of Tink and sustainability fintech firm CoGo, this feature can nudge consumers on how to reduce their carbon footprint by using location information that is shared with others.

A trial run found that users of this tool had reduced their monthly CO_2 emissions by 11kg. It had encouraged behavioural changes too. Testers reported that they had started composting and eating less meat, for instance. Some were even prompted to switch their energy provider.

"It's important to raise our customers' awareness of the environmental impact of their spending and how they can make positive changes," says NatWest Group's chief digital officer for retail banking, Wendy Redshaw. "The feature provides hints and tips on how to develop greener habits. It also enables users to log their commitments and behavioural changes."

NatWest plans to install further sustainability features in its app, including one that will suggest things that customers can do to make their homes greener.

Are these prompts enough to catalyse meaningful change? After all, consumers often exhibit an intention-action gap, which is when their values and opinions don't match their purchasing decisions.

A survey published by EY last year found that 84% of consumers considered sustainability to be important when making purchasing decisions, yet the firm considered only 18% of those respondents to be "planet-first" shoppers.

Gustaf Anselmsson is the co-founder and CEO of Gokind, a sustainability price comparison service (also based in Sweden). He believes that "people agree on the value and importance of topics such as sustainability and diversity. We have this picture that whatever a consumer says their value is, this is how they will act. This doesn't mean that you have frauds as your consumer base. It means that we're easily persuaded by the perverse incentives of marketing and sales."

Using Tink's application programming interface, Gokind analyses banking data to suggest more ethical consumer choices. Anselmsson says that the firm takes a holistic approach to sustainability and ranks businesses on diversity practices as well as their environmental impact. Users are given cash rewards for switching to the highest-rated brands on the platform. It suggests small changes first, such as shopping on second-hand clothes sales sites rather than using fast fashion, before suggesting more laborious switches such as changing an energy supplier.

"We haven't stumbled upon anyone that feels joy in switching energy suppliers," Anselmsson notes. "Even if you enjoy being sustainable, it's quite heavy to flick through a sustainability report. Rather than telling customers: 'This is your life: you have twice the emissions you should have. Do these 20 things and completely change your lifestyle,' we're rewarding them and trying to move them gradually."

These changes in consumer behaviour should in turn penalise firms that aren't prioritising sustainability. An increasingly environmentally savvy consumer base that's making the 'right' choices could soon expose these laggards.

> **Even if you enjoy being sustainable, it's quite heavy to flick through a sustainability report**

Current EU regulations require companies with more than 250 employees to report their diversity and sustainability efforts. New legislation introduced this month requires UK-based businesses with more than 500 employees to report on their environmental impact.

Anselmsson believes that the widespread use of open banking data creates an imperative for larger companies to improve, and for smaller operations to report their ESG efforts.

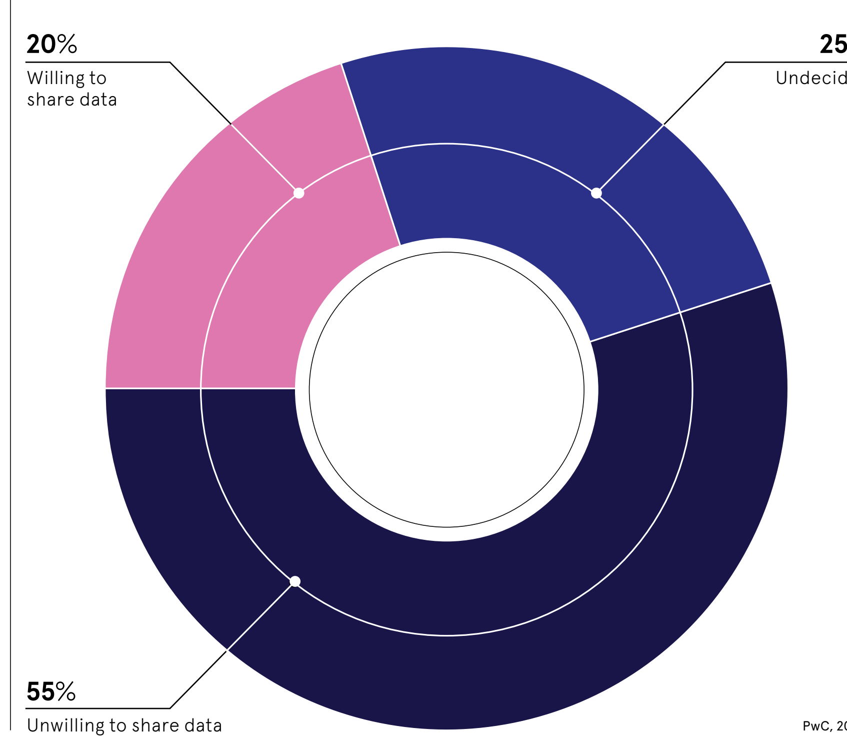
"We can indirectly incentivise small and medium-sized enterprises and companies that don't have a legal requirement to report," Anselmsson says. "We're trying to create a natural urgency for businesses of all sizes to improve."

Greenly's co-founder and CEO, Alexis Normand, agrees. "Businesses often begin their 'climate journey' when a customer requires them to report it, because they are themselves working for a larger company that wants to cut emissions in its supply chain," he says. "When you start losing business because you're making fewer sustainability efforts than your peers, a low-carbon strategy suddenly shifts from a 'nice to have' to a 'must have'."

Greenly uses data from an SME's banking and accounting output, and information sources such as cloud computing usage and travel software, to calculate the carbon footprint along its value chain. Working with these third parties can put pressure on the large financial institutions. Tink's research indicates that 52% of 18- to 34-year-olds wouldn't bank with a provider that held assets or investments contributing to climate change.

"Younger consumers are demanding that providers are climate conscious and that their money is invested ethically and sustainably," Chouhan says. "Open banking forms a big part of the answer – by enabling banks to understand the carbon footprints of their customers and, in turn, the climate liabilities on their books."

EUROPEANS' WILLINGNESS TO SHARE DATA VIA OPEN BANKING IN EXCHANGE FOR BENEFITS IN 2020



PwC, 2020

Commercial feature

How SMEs are benefitting from open banking

Open banking has revolutionised the way businesses access loans – and, crucially, the speed at which they are approved for credit

Existing processes for SMEs to obtain loans can take days and involve cumbersome manual processes that are not always fair to the applicant and can be susceptible to fraud.

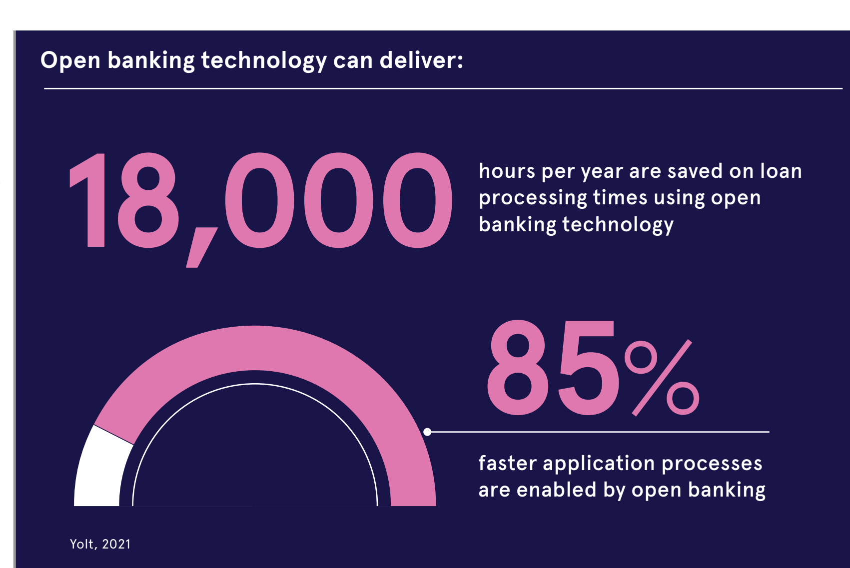
But a new range of services are opening the doors for SMEs to obtain access to loans and credit in a much shorter time frame – in some cases minutes rather than days – and with more reliable and accurate data.

This is thanks to open banking. Launched in 2018, this legislation requires banks, with strict rules around security and customer consent, to grant third parties access to their customer's bank account data.

This has unleashed a new wave of innovation in the SME lending space. For example, open banking technology provider Yolt recently launched a plug-and-play tool called Cashflow Analyser. Built on its open banking connections, it enables lenders, leasing companies and credit-checking services to access the bank accounts of credit applicants, gleaning insights into their cash flow to speed up credit checks.

For example, with Cashflow Analyser, a credit-check specialist can gain better data on credit applicants and deliver an instant verdict. Or a car leasing company can work out if a business looking to lease vehicles is in a good position to service the account and pay on time.

> **With Cashflow Analyser, SME lenders can drastically speed up the lending process**



"This is a game changer in the way we provide insights into the SME's business," says Nicolas Weng Kan, CEO of Yolt. "Until now, credit checks have been a time-consuming, paper-based process that required applicants to send in reams of account information for analysis. Cashflow Analyser uses open banking transparency to automate the process. In fact, we calculate that our technology can reduce processing times on borrowing applications by 85%, and saving lenders up to 18,000 hours per year."

Cashflow Analyser can be a valuable tool for a range of businesses that lend or lease to SMEs. Furthermore, Yolt is offering Cashflow Analyser as a white label product to other companies, and the company believes the technology could be a turning point both for credit providers and for SMEs who need to access loans quickly.

One such company is multinational business information giant Creditsafe, which is embedding Cashflow Analyser into its credit process. Creditsafe provides business intelligence information and has offices in 13 countries globally. Using Cashflow Analyser, Creditsafe analysts will have access to cash flow data about credit applicants, improving transparency and speeding up the process.

"The partnership with Creditsafe enables them to add a valuable, reliable and accurate data source to their credit-decisioning processes," added Weng Kan. "And we are looking forward to helping more businesses in the UK and across Europe to make better lending, credit and leasing decisions."

To find out more, visit yolt.com

YOLT

Commercial feature

Is fear of fraud standing between you and good customers?

Businesses must provide both strong security and an excellent user experience online. Yet striking the right balance can be hard, says Mitek, a global AI-based identity solutions provider

Your business is growing fast and onboarding good customers quickly is paramount, but you need to be sure they are who they say they are. How do you protect yourself and your customers from fraud?

Trust is the lifeblood of a successful business, allowing you to connect with your customers in a sustained and meaningful way, while building your brand and growing your sales. Yet, in the digital age it is a commodity in short supply and firms are under pressure to bridge the growing divide between the physical and online worlds.

Part of the problem is that, in the past, firms usually met their customers before doing business with them, making it easier to establish a basis of trust. Now, however, most of these interactions take place online, consumers are more sceptical, and the risk of fraud is rising.

Identity fraud losses in the US, caused by criminals illegally using victims' information to steal money, surged to $24bn in 2021, according to the consultancy Javelin Strategy & Research. That was up 79% from 2020, while the number of adults impacted grew by more than 50% to 15 million.

79%

of UK respondents said they wanted their bank to adopt the latest technology to keep their accounts safe. Yet...

19%

said they abandoned opening an account because it was too time consuming or difficult

Mitek, 2022

Risks to brand perception

In the current climate, businesses face a series of threats, not least of which are those that impact perceptions of their brand.

Public trust in institutions of all kinds is already at a low and customer loyalty is no longer a given. Nearly six in 10 people say their default tendency is to distrust something until they see evidence it is trustworthy, according to the latest Edelman Trust Barometer, which tracks public trust in businesses, NGOs, government and the media.

To protect themselves, companies must ensure that their customers' personal data is safe online and their identities are protected. Robust defences must be implemented to avoid breaches and the reputational damage they can cause.

Yet, firms are also expected to provide a user experience (UX) that is second to none and many struggle to strike a balance. In a rush to fortify their defences, they deploy onerous security systems that impair the functionality of their apps and websites, making them less enjoyable and less convenient to use.

That in turn makes it harder to onboard high-quality customers, harms conversions and puts profitability at risk.

Sanjay Gupta is senior vice-president and managing director at HooYu, a Mitek company. He says he understands fraud is a big concern but cautions that it's a mistake to think that safety and security online should come at any price.

"Delivering a poor user experience is a far bigger threat to your business. Ninety-eight to 99% of your customers pose no risk at all and the cost of alienating them is high."

Striking the right balance

According to a recent YouGov survey for Mitek, 79% of UK respondents said they wanted their bank to adopt the latest technology to keep their accounts safe. Yet 19% said they abandoned opening an account because it was too time consuming or difficult.

It mirrors wider research that shows the harder a website is to use, the more likely a visitor is to leave before completing a transaction. According to the Baymard Institute, a UX research consultancy in Denmark, some seven in 10 visitors to an ecommerce site abandon their shopping carts before reaching checkout.

In a fast-changing digital market, companies must adapt. Yet some are encumbered by legacy IT systems and can't innovate fast enough. Others meanwhile can't find the external support they need and are outpaced by more nimble rivals.

However, Gupta believes that with the right technology and strategy, businesses can deliver both exceptional digital experiences and robust fraud prevention at the same time.

His company Mitek is an AI-based identity solution provider offering a comprehensive set of native and external identity verification signals with powerful orchestration and configuration tools to build tailored onboarding workflows. It has powered bespoke solutions for thousands of the world's leading banks, fintechs and marketplaces. "Too often firms rely on a narrow menu of tools that are not flexible enough to meet their needs," Gupta explains. "Customization and control are key when building an effective solution."

Know your customer

The Nasdaq-listed business is best known for technology that allows firms to verify people's identity with patented algorithms that capture, classify and verify photos of identity documents such as passports, ID cards and driver's licences.

However, it is its platform technology that is revolutionising the 'know your customer' (KYC) journey for companies. The tech can be easily incorporated into a firm's digital architecture on a 'low code, no code' basis without an army of developers, and is customisable to match different customer risk, product, or lifecycle scenarios. Crucially too, it simplifies and streamlines the experience of the end user.

"The platform is engineered to maximise onboarding success," says Gupta. "It enables organisations to create fast, flexible and easy-to-configure workflows that meet their exact needs, ensuring new customers can be onboarded quickly and with minimum friction."

To date, Mitek has worked with an array of different businesses from tech startups such as Airbnb to major retail banks such as Chase.

For businesses looking to build lasting and trusted relationships, Gupta advises being transparent with consumers. "Trust doesn't just come overnight; it's built gradually and through the ups and downs. Firms who show that they are serious about security, tough on fraud and communicate what they are doing and why will have the best results. This transparency in communication will send the right message to the customer."

> **Trust doesn't just come overnight; it's built gradually and through the ups and downs**

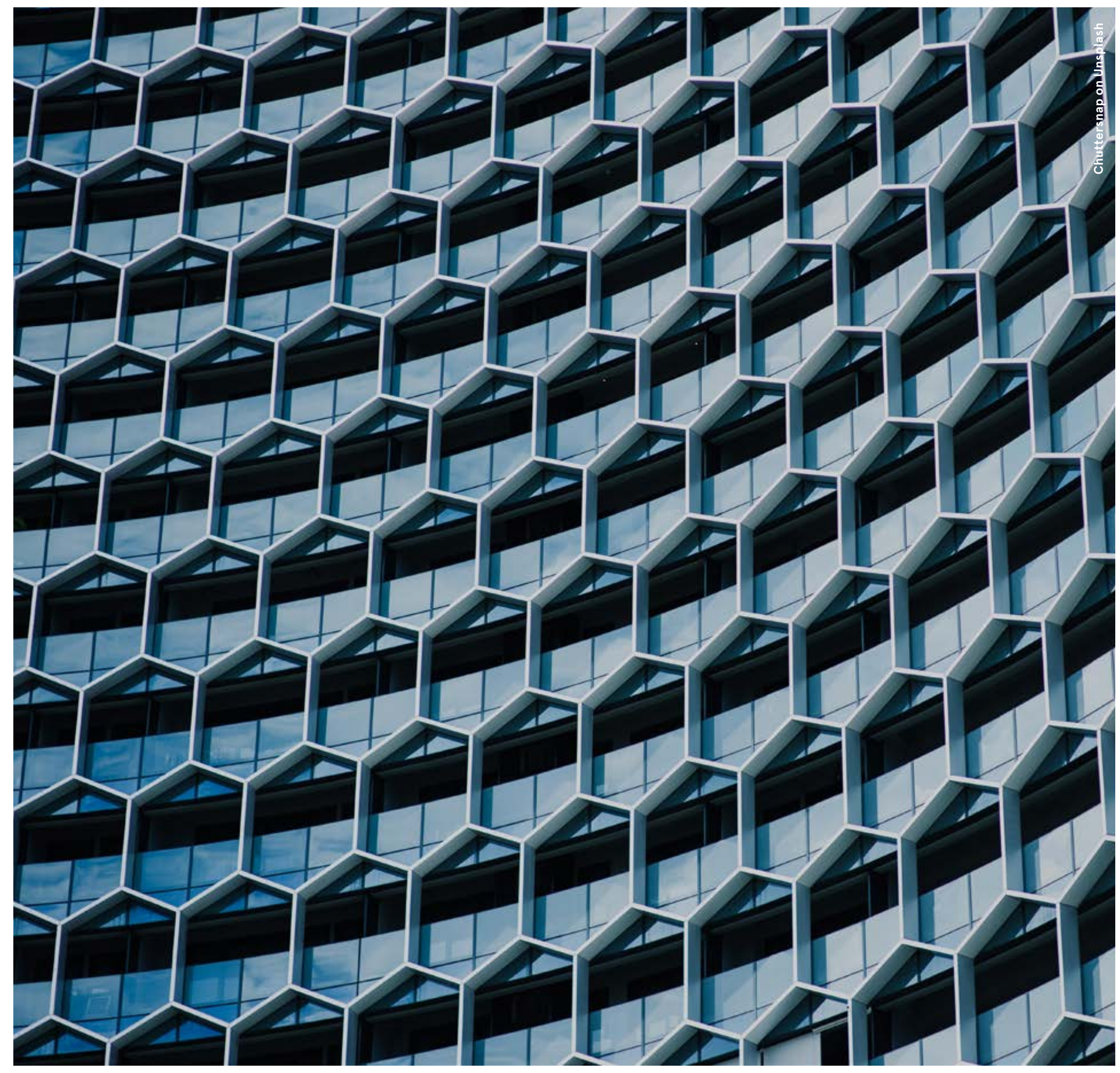
He also advises companies to educate customers about advances in cutting-edge security processes such as facial recognition and biometrics. "These technologies have attracted negative headlines but when used properly and ethically they can be highly effective. In time, they will replace passwords as the default method of entry to digital spaces. So, it is up to companies to explain the benefits, dispel the myths and show that privacy isn't at risk."

Most importantly, Gupta says firms must remember that most people are honest and a heavy-handed approach to fraud and verification can be counterproductive.

"Customer experience and safety on your platform is the number one priority. Strong trusting relationships lead to business growth and customer loyalty, it's as simple as that."

INNOVATION

Transformative tech – which stack to back?



Cluttersnap on Unsplash

A whole array of emerging technologies could give a key competitive edge to a bank that can apply them successfully. How do their innovation specialists go about finding a winning combination?

Oliver Pickup

In the long shadow of the 2007-08 global financial crisis, concurrent advances in three technologies – smartphones, 4G networks and cloud computing – sparked an explosion of innovation in financial services. Their convergence enabled mobile banking: the sector's most significant development in generations.

Just over a decade later, the industry is again "on the cusp of another inflexion point". That's the belief of Prakash Pattni, managing director of digital transformation at IBM Cloud for Financial Services. He predicts that progress in tech including 5G, blockchain, artificial intelligence and quantum computing will trigger "another spurt" of innovation.

"People talk about data being the new oil," Pattni says. "Well, blockchain is the new oil rig, and AI is the new refinery. The coming together of these things makes it an exciting time to be part of the industry."

Given that R&D is notoriously costly and success is never guaranteed, how do banks approach experimenting with tech that might just as easily fall by the wayside as revolutionise their industry?

As head of innovation, global functions, at HSBC, Steve Suarez is particularly well qualified to answer this. He believes that the secret to successful innovation is to remain focused on "how to make things cheaper, faster and frictionless for people". The bank is "constantly scanning the horizon to see how we can apply new technologies. We want to gather data that enables us to personalise banking and give our customers what they need, quickly but also securely."

The London-based American applies what he calls a "three horizon" approach to innovation. Horizon one concerns "the stuff that we already know well and will incrementally improve things in the short term. Horizon two, which is about two or three years from now, concerns technologies that are fairly new to the industry – blockchain, for instance. We look at how we can provide use cases with these to make the bank better."

He continues: "And then there is horizon three, which is all about the long shots. These include the metaverse and quantum computing, which could turn out to be a game-changer for financial services."

The possibility that a horizon-three punt might come off is clearly exciting to Suarez, but he is careful not to get too preoccupied with the potential benefits of such advances.

> **People talk about data being the new oil. Well, blockchain is the new oil rig and AI is the new refinery**

"We're all betting on these technologies to achieve an advantage. There are huge opportunities, but we also need to look at the risks from a security perspective and work out how we might need to structure ourselves," he says. "The bank processes 1.5 trillion transactions a day, so we do understand our great responsibility to protect all customers."

HSBC's recent horizon-three R&D activities have included recruiting experts in quantum computing and announcing a three-year collaboration with IBM to explore applications for this nascent tech and so ensure its "organisational readiness" to take full advantage of it.

The bank has also bought a plot of virtual real estate in an online gaming space called The Sandbox, marking its first significant foray into the metaverse.

The term 'metaverse' was coined by sci-fi writer Neal Stephenson in his 1992 novel *Snow Crash*. He was referring to a digital realm in which humans, avatars and software programs could interact and where property could be purchased. Suarez indicates that HSBC intends to stay loyal to Stephenson's original meaning.

"We'll be building on our plot, putting in virtual stadiums and working out how to better serve our customers," he says, hinting that the bank might seek to engage with sports and e-sports fans in the metaverse.

Jehangir Byramji is senior innovation manager and fintech lead at Lloyds Banking Group. He also revels in exploring potentially transformative emerging tech and "analysing weak signals from other markets and regions that the bank can use in the future".

Byramji's approach is slightly different from that of Suarez, though. He organises the bank's IT innovation work into three broad categories: data; AI (particularly machine learning); and Web3 (tech based on decentralised systems such as blockchains) and the metaverse.

"On the data side, there's this whole idea of 'hard' and 'soft' identities. Younger people are more worried about losing their social media profile than their passport," he says. "They are more likely to embrace machine-to-machine payments. As a bank, you therefore need to think about non-traditional ways of processing their data."

In this category he also places digital twins – virtual representations of real entities "to help you understand both your own organisation and its customers and clients".

But Byramji is most enthused by the latest developments in machine learning. "You'll see more intelligent agents, just as much in the physical world as in the data realm," he says, adding that the internet of things will play a key role here. "Some of our clients have connected factories or farms – the modern combine harvesters are covered in sensors, for instance – so we're asking how we can use the data these smart machines gather in an intelligent way and work with clients to better serve them."

Given the sheer range of possibilities, banks must stay focused on use cases that are most likely to benefit the customer, Byramji stresses. Otherwise, it's a waste of time, money and effort.

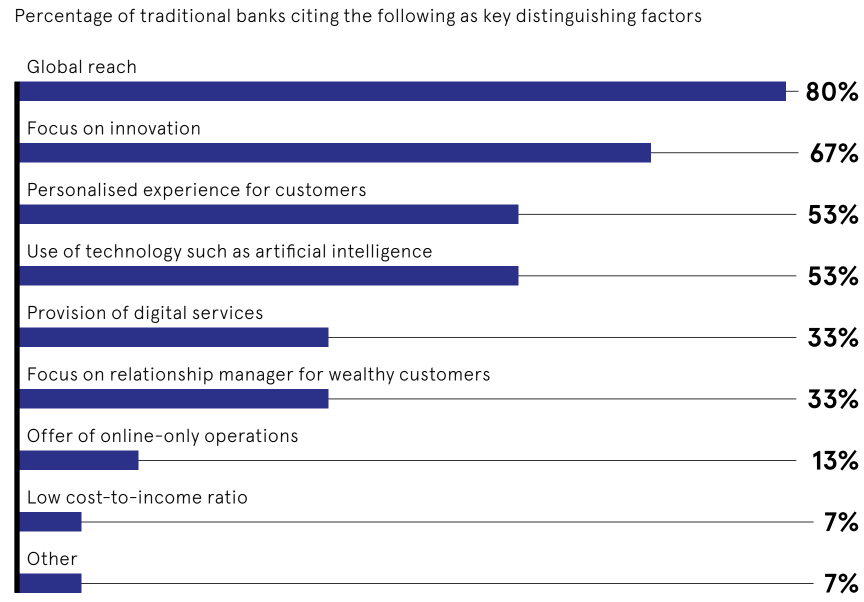
"We're starting to see quite gimmicky AI, with deep-fake videos and things like that," he says. "While they are interesting developments, we have to remember our first principle: better serve our customers."

That said, Byramji cannot help but be fascinated by the longer-term potential offered by Web3.

"Banks are unpicking blockchain technologies more effectively than they did a few years ago. We're starting to understand smart contracts and other capabilities that minimise risk and build trust," he reports. "With these related technologies, we can form relationships with fintech firms, build ecosystems, develop new markets and unlock some exciting opportunities."

HOW TRADITIONAL BANKS DIFFERENTIATE THEMSELVES FROM THEIR RIVALS

Percentage of traditional banks citing the following as key distinguishing factors



SAS Institute, 2021

CRIME

UK watchdog bares more teeth in its war on money-laundering

The Financial Conduct Authority is wielding powers that it's rarely invoked in an effort to change the nation's shameful reputation as a hive of criminal activity

Simon Brooke

Robert Evans / Alamy Stock Photo

The debate about the presence of Russian oligarchs and their vast assets in the UK after the Putin regime's invasion of Ukraine has pushed the problem of money-laundering up the political and regulatory agenda.

An estimated £88bn is laundered each year in the UK, according to research by Credas Technologies, a specialist in ID verification software. Based on data from the OECD, its figures indicate that only the US (£217bn) is home to more money-laundering. The UK's figure is well above that of France (£55bn) and Germany (£51bn). Yet there is evidence that even before this sudden – and, many would say, overdue – concern in the UK about the scale of criminal activity, the authorities were already starting to take a tougher line on the issue.

The Financial Conduct Authority (FCA) has started using its power to mount prosecutions on top of imposing regulatory penalties and civil fines against money-launderers. The regulator was granted this capability in 2007, but it was only in October 2021 that it secured its first conviction. NatWest was fined £264.8m for failing to properly monitor the activity of a commercial customer, Fowler Oldfield, a jewellery business based in Bradford. During the time that NatWest served as the firm's bank, approximately £365m was deposited with it, of which about £264m was in cash, even though their original business arrangement did not cover the management of cash.

Even though some employees at the bank reported their concerns, no appropriate action was taken. According to the FCA, the 'red flags' included significant numbers of Scottish bank notes deposited throughout England; notes arriving with a distinctly musty smell; and individuals acting suspiciously when paying cash in at branches. In some cases, the money arrived in bin sacks. NatWest admitted to three offences under the Money Laundering Regulations 2007 (MLR).

"Tackling financial crimes including money-laundering and financing terrorism is a priority," says an FCA spokesman. "Financial crimes harm society and the wider economy, eroding confidence in the UK financial system. It's imperative that the UK, as an international financial hub, has an effective regime to counter them. The FCA is committed to making the UK banking sector a hostile environment for money-launderers."

The regulator has 42 other anti-money-laundering probes into firms and individuals in the pipeline, but only three of these are criminal investigations. The extra effort needed to mount a successful prosecution is significant.

Giving evidence to the Treasury select committee, Nikhil Rathi, the authority's CEO, revealed that the Fowler Oldfield case had required 30,000 hours of staff time, interviews with 85 witnesses and forensic reviews of 300,000 documents, as well as 350 separate exchanges of legal correspondence with the bank. Not surprisingly, criminal prosecutions under the MLR are warranted only in "the most egregious cases", according to the FCA.

James Alleyne, legal counsel at law firm Kingsley Napley, previously worked in the FCA's enforcement division. He notes that "the successful prosecution of NatWest for offences contrary to the MLR is new territory for it. This reflects an increasingly aggressive and creative approach to the treatment of serious misconduct."

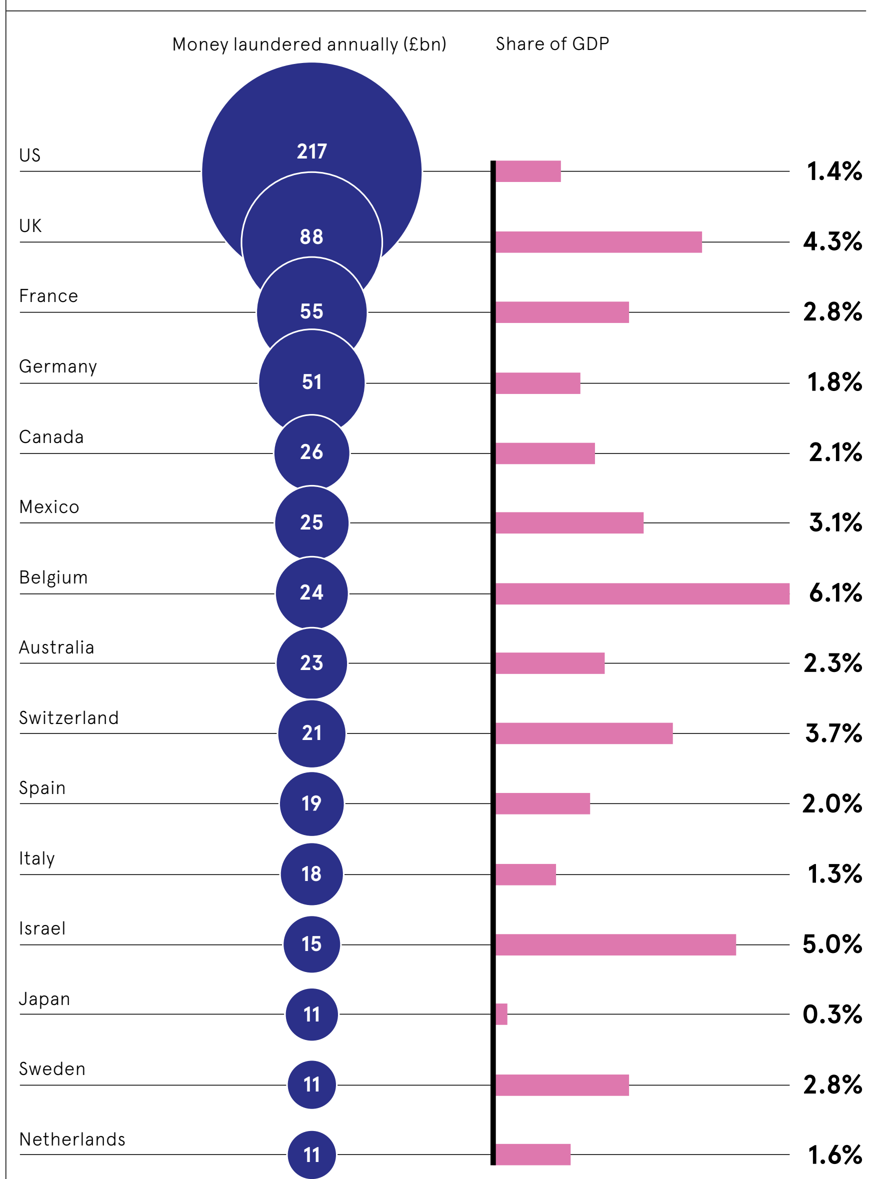
Unusual though it might be, the Fowler Oldfield case should spur banks and other regulated businesses to review their anti-money-laundering practices and ensure that their 'know your customer' activities are fit for purpose. A call for evidence by the government in July on the regulatory and supervisory regime also suggests a greater desire in Westminster to pursue criminal prosecutions wherever possible.

£1.8tn

Total funds estimated to have been laundered annually worldwide, equating to about 3% of global GDP

Credas Technologies, 2022

OECD COUNTRIES RANKED BY ESTIMATED MONEY-LAUNDERING ACTIVITY



Credas Technologies, 2022

> **The government needs to massively increase law enforcement agencies' budgets, so that they can devote the same effort to attacking illicit wealth as its owners put into defending it**

While enforcement investigations and financial penalties seek to punish previous misconduct, they don't aim to mitigate the ongoing threats posed by weak controls against financial crime. According to Alleyne, there's little doubt that the FCA is adopting an increasingly assertive approach to the supervision of regulated businesses. This, he says, follows the report by Dame Elizabeth Gloster into the collapse of investment firm London Capital & Finance, which left 11,000 people fearing the loss of their life savings.

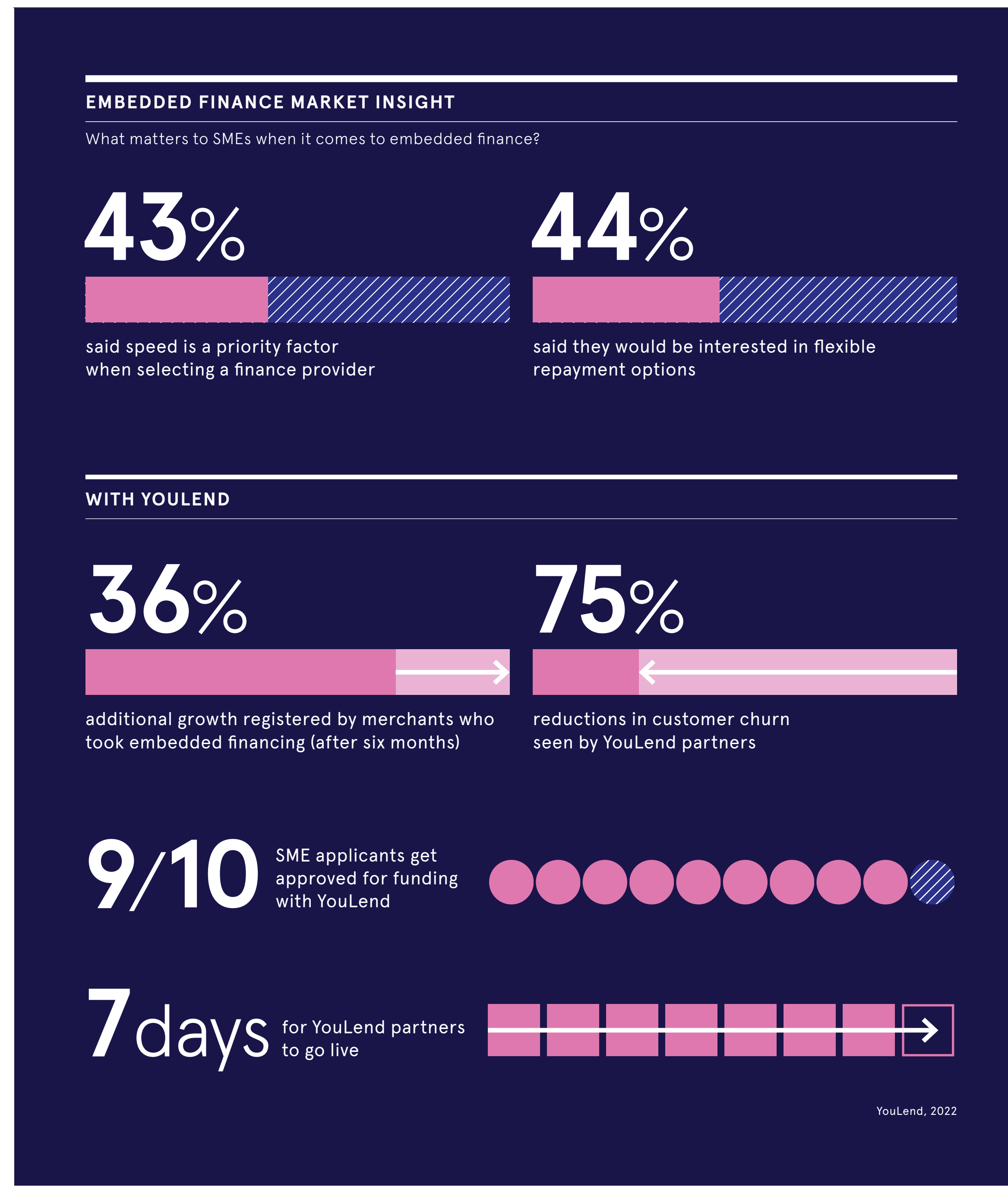
"Firms with ongoing weaknesses in their financial crime defences can expect increasingly intrusive supervision by the regulator, including the imposition of requirements on the FCA's own initiative," Alleyne explains. "These can prevent a firm that's undertaking any activity – regulated or unregulated – from taking on new clients or serving existing clients." This can result in "significant costs and disruption" to the businesses concerned.

Other observers have broadly welcomed the FCA's tougher approach but would like it to go further. Oliver Bullough, author of *Butler to the World: how Britain became the servant of tycoons, tax dodgers, kleptocrats and criminals*, points out that billions of pounds are "laundered through the City every year. These funds are the fruits of kleptocracy, fraud, tax evasion, drug dealing, people trafficking and more."

Bullough argues: "If this country wants to put an end to such crimes, it needs to make laundering their proceeds risky – and right now it's not doing that. To fight financial crime, law enforcement agencies need three things: resources, information and support. To help them, therefore, the government needs to massively increase their budgets, so that they can devote the same effort to attacking illicit wealth as its owners put into defending it."

In some countries, extra investments in anti-money-laundering enforcement have produced a healthy return, as fines are imposed and profits are properly taxed. Bullough and other campaigners are calling for political support for those involved in a highly complex and sometimes risky area of law enforcement that can cause embarrassment for the rich and powerful.

"There are many factors that make London an excellent centre for money-laundering. The total shambles of our law enforcement system is just one of those," Bullough argues. "Solving a problem this big will take years of careful, dedicated work, rather than just one case. I hope this is the start of that process, rather than an isolated spasm." ●



How embedded finance drives the growth of your merchants

YouLend enables ecommerce platforms and payment service providers to fund merchant expansion and create stickier, more valuable relationships

It's beginning to feel like one of the longest hangovers in history. Nearly a decade and a half after the great financial crash, small and medium-sized enterprises (SMEs) still struggle to access finance from traditional sources.

Alternative finance has flooded in to fill this bank-sized hole in business lending. We can see it in the growth of venture capital and private credit. And we can also see it in the astonishing rise of embedded finance.

Embedded finance is the phenomenon of non-bank businesses offering financial services alongside their traditional offering. That can mean a small business getting a bank account through its accounting software or a consumer taking a buy-now-pay-later deal from a retailer. Last year, Ikea took a 49% stake in its banking partner so it could offer more financial services in-store.

In the business finance space, embedded finance is taking off as a way for small and medium-sized merchants - often those that predominantly operate online - to access the funds they need to grow.

Mikkel Velin is founder and co-CEO at B2B embedded finance provider YouLend. He argues that, for many merchants, bank finance is no longer realistic, even if they can get it.

"A merchant might typically wait between three and nine weeks for a financing decision from a bank and then the bank may well say no," says Velin. "Even if they say yes, that's a lifetime for an entrepreneur."

Close business relationships

With that in mind, merchants are looking for rapid access to growth funds without the rigmarole of a lengthy application process that often ends in rejection.

Increasingly, they're getting it from the organisations with whom they have the closest business relationships. That used to be banks. Today, it's ecommerce platforms and payment service providers.

That's a profound change in the way SMEs access growth capital. Ecommerce platforms such as eBay and Shopify, as well as payment service providers like Dojo, now appear best placed to fill the gap left by banks because of the deep relationships they already have with their merchant customers.

In the embedded finance model, merchants get rapid access to financing from a source they trust. But what's in it for partners? Do they really want to complicate their operations by getting into the financing business?

The simple answer is they usually don't. So they leave the heavy lifting to an embedded finance partner like YouLend. The company works with global ecommerce platforms, including Shopify and eBay, and payment service providers like Dojo, Paymentsense and Retail Merchant Services, to offer rapid finance solutions to their merchant customers.

Partners get an easy way to offer embedded finance, and with it a clear competitive edge. Merchants with access to this kind of flexible financing tend to sell more, driving up revenue across the value chain. Figures show that when merchants take finance through YouLend partners, their sales rise by between 15% and 36% on average.

That's far from the only benefit, according to Velin. "When finance is available from their partners, merchants are more loyal," he says. "Merchant churn declines by between 50% and 75%."

Combining rising sales and reduced churn leads to a significant increase in the lifetime value of merchants, a key metric for both ecommerce platforms and payment service providers.

> **Partners get an easy way to offer embedded finance, and with it a clear competitive edge**

Overcoming traditional obstacles to finance

Embedded finance, especially from a sophisticated provider like YouLend, also overcomes another common obstacle to small business funding: a lack of inclusivity.

Banks continue to rely on traditional risk models that usually involve the analysis of a couple of years of annual accounts. This provides a historic picture of performance that automatically excludes younger businesses.It also excludes a lot of established businesses whose upward growth trajectory is yet to be reflected in annual accounts.

Embedded finance sidesteps this issue by using the alternative data created by online commerce. YouLend's risk assessment model combines details of a merchant's digital footprint, social media presence and website traffic with payment data to paint an up-to-the-minute picture of performance and risk.

The result is that more good merchants can access the finance they need to grow, with all the benefits that brings for their hosting or payment partners.

The competitive advantage

Larger partners use embedded finance to expand their offer to merchants and as a key point of differentiation from their competitors. It isn't really a revenue stream.

Smaller partners may be more inclined to monetise this financing, but they understand that long-term success depends on the health and happiness of their merchant base.

Embedded finance also helps ecommerce platforms and other service providers to internationalise their operations. Naturally, they want to offer merchants the same seamless experience wherever they are in the world.

YouLend uses the same alternative data points for risk assessment and credit scoring whether a merchant is in the UK, Poland, the Netherlands or elsewhere in Europe. Merchants get a consistent experience, while partners get a one-stop shop for their global financing strategy.

Embedded finance creates lasting relationships

For merchants, the draw in all this is obvious: a trusted, predictable route to funding that, as Velin says, could hardly be easier to access.

"We scrape anonymised data from our partners' platforms, which means merchants have, in effect, been pre-screened," he adds. "That means a large number of our financing decisions are instant, and around nine out of 10 are positive – meaning the merchant's application is accepted."

Merchants are reassured by the anonymised nature of this due diligence and the fact that YouLend works in partnership with the ecommerce platforms and payment service providers they already trust.

Velin says that YouLend treats merchants with the same care they expect from eBay or Shopify. Everybody wins when merchants thrive.

All of this signals a profound structural change in the way SME finance works. Banks - local by nature - are being superseded by digitally savvy alternative finance providers with a global outlook.

Banks still provide capital, but the face of SME finance - at least in the online space - is moving to the key partners merchants deal with every day. YouLend gives those platforms and providers the tools to create new value and nurture more lasting relationships.

For more information please visit youlend.com

YOULEND

Kal Visuals on Unsplash

LENDING

Enter now, profit later: why the interest rate in BNPL is on the rise

The expansion of the buy-now-pay-later market in recent years has not been lost on the banking industry. Big names in the sector are set to launch products of their own

Ouida Taaffe

When Swedish fintech company Klarna brought its buy-now-pay-later (BNPL) service to the UK in 2016, the provision of interest-free credit at the point of sale looked like a sideshow. But, as the innovative payment method has attracted growing interest from consumers and retailers, it has persuaded big incumbents such as NatWest to join the fray.

It's still early days for the BNPL market, which remains dwarfed by the credit card market. There are 35 million active credit cards in the UK, on which £16.2bn was spent in January alone, according to UK Finance. By contrast, BNPL was used at least once by about 15 million people (about 28% of the country's adult population) in October 2021, with the average user repaying £125.32, according to Equifax. These figures suggest that overall BNPL lending is about 10% of the total lent on credit cards.

Nonetheless, banks are keen to tap into this developing market. NatWest looks likely to be the first big player to enter this arena, launching a product this summer. It's promising to bring one of the main benefits of a credit card to BNPL: "consumer protection on all purchases". BNPL is also set to feature on the NatWest mobile app, with the bank aiming to offer its customers an "effortless" experience.

NatWest hasn't given details of what it might charge retailers. But it's possible that the sheer size of the business could help it to undercut fintech BNPL providers. It may also have another advantage: incumbents are experienced in regulatory compliance.

NatWest won't be the first UK bank to take the plunge. That distinction is held by app-based challenger Monzo. Launched at the end of 2021, its Monzo Flex facility enables interest-free repayment in three instalments, though it has an interest rate of 19% APR if a customer chooses six or 12 instalments. From a consumer's point of view, this is similar to a credit card.

BNPL could eat into a much bigger, established business – so why are banks interested? It comes down to consumer expectations, increasing choice and why BNPL took off in the first place.

It attracts consumers partly because it's accessible to people who can't get a credit card or don't want to undergo a hard credit check. In the UK, BNPL still comes under rules that allow informal credit agreements – for instance, settling up with a newsagent at the end of the week – although that situation will change shortly. Mainly, though, it's because it's cheaper and less hassle.

It's particularly important to consumers that BNPL costs less to use than a credit card or an overdraft, according to research by Bain. Some providers, including Klarna, charge no interest or late repayment fees on smaller sums. Klarna has a regulated credit offer for larger amounts that does charge interest, but there is a fixed total cost and no revolving credit.

By contrast, the average cost of credit card borrowing was 18.28% in January 2022, while the effective interest rate on overdrafts was 20.83%, according to the Bank of England.

Klarna has described the credit card markets as "rigged" against both consumers and merchants, working only in favour of banks that extract excessive fees. It's far from the only fintech company that can see a business opportunity in the margins. Shachar Bialick is the founder and CEO of Curve, a banking platform that consolidates a user's multiple cards into one card and app. It has also started offering BNPL credit. He believes that "BNPL can absolutely displace credit cards in the UK".

BNPL offers a range of other advantages. Card providers such as Visa, which have big economies of scale, charge retailers under 2% for the credit service. BNPL can demand more than twice as much.

On the surface, that seems potentially offputting for retailers, which have long complained about excessive card charges. But BNPL's special sauce is that it boosts sales compared with other payment options. That matters in an online world where the competition is one click away. Bain says that about 57% of merchants offering BNPL options see an increase in their 'basket conversion' rates and about 46% enjoy an increase in order value.

BNPL also attracts a broader range of consumers, including the less wealthy. All in all, retailers find that it pays for itself even if it comes with a higher percentage fee than a card payment. The bottom line is that consumers flock to such solutions, meaning that both retailers and banks will increasingly have to make them accessible.

"The fintech sector emerged out of demand for more diverse products that work for consumers as well as providers," says Claudio Alvarez, partner at GP Bullhound, a technology advisory and investment firm. "Klarna and others have revolutionised the consumer lending space. It was only a matter of time before incumbents took notice and began adapting their offerings to keep in step."

Though retailers are keen to offer BNPL, it's not lucrative for the finance providers – at least not yet. Klarna, the UK's largest BNPL player, reported a global revenue of $1.6bn and a net loss of $758m in 2021 as it expanded (it now operates in 45 countries). Visa's net income last year was $12.3bn.

> **Klarna and others have revolutionised the consumer lending space. It was only a matter of time before incumbents took notice**

But Klarna, like many tech companies, wants to reshape its whole market for the long term, not make money now. It aims to be a major aggregator that takes only the slimmest of margins by eliminating what it sees as unnecessary financial taxes on the economy. If it succeeds, some banks will have to formulate new business models.

There are also regulatory issues to consider. UK regulators started taking a hard look at BNPL with the Woolard review in February 2021. This concluded that "as a matter of urgency, the Financial Conduct Authority should work with the Treasury to ensure the necessary amendments to legislation are made to bring BNPL products within the scope of regulation." That is expected this year.

Incumbent payment companies, including banks, already comply with long lists of often onerous regulations on a global basis. This underpins their reach and scale. Some challenger banks, by contrast, have struggled to keep up with the demands of compliance in the domestic market.

Experience in compliance could prove highly advantageous in a more regulated BNPL market. No one has suggested that firms such as Klarna don't run their businesses well – and Klarna itself welcomes regulation. But, while some challengers are getting their knuckles rapped for poor back-end processes, the incumbents are built to respond to regulation. With regulated BNPL, they have a chance to step into a ready-made and growing market that suits their particular skills. ●

AVERAGE BUY-NOW-PAY-LATER DEBT BY PLATFORM IN THE UK IN 2021

money.co.uk, 2021