INSIGHTS

JANUARY 2017

7 BANKING TRENDS TO WATCH IN 2017

Brian McConnell and Michael Nolan

WELLINGTON
Consulting Group

Banks across the world are struggling. The current environment of prolonged slow growth coupled with historic low interest rates, a continuing barrage of new regulations and the threat of upstart FinTechs have taken their toll on banks. Arguably Canadian banks are faring better than most if not all other counties but can that continue?

In this Insights paper we will explore the 7 trends for Banks in 2017 and beyond.

1. **"Basel IV"** – Technically this is the "recalibration" of Basel III but the potential impact is so pervasive the industry has dubbed it Basel IV. While Basel III was focused on capital levels and quality, Basel IV will focus on Risk Weighted Assets (RWA). Early estimates are that it will result in an increase of total market risk capital requirements in the range of 20% to 50%. At 50% many banks around the world would face significant shortfalls in currently available capital. A PWC study[1] estimates that Europe's banks would move from their current aggregate RWA of £10.9 Trillion to as much as £18.1 Trillion resulting in aggregated increase in capital requirements from £1.1 trillion to approximately £2.0 trillion. Not surprisingly many of Europe's banks would fail in this scenario. But even if it's only 20% this will put tremendous pressure on the profitability of many banks and divert capital away from other critical initiatives.

[1] *Strategy&, Fourth Time around? European banks confront "Basel IV", by Dr. Phillip Wackerbeck, Jeroen Crijns, Dr. Christel Karsten, Felix Becht. PwC 2016.*

2. **FinTechs** – According to the PwC Global Fintech Report[2], technology is still being met with both fear and resistance by many large financial institutions. The report indicated that 60% of asset and wealth managers are fearful of losing part of their business to Fintech companies, and that 58% do not believe their business needs a mobile app. The taxi industry thought the same thing when Uber became popular.

   Established banks still enjoy certain advantages over the start-up FinTechs. But like the taxi industry these advantages won't last long unless the established banks change thier perspective and embrace technologies used by FinTechs. Simply put, if you're not the institution that makes getting a mortgage online as easy as it is to call an Uber, you'll be losing significant market share.

   If you're not already doing some of following, you need start in 2017:

   a. Significant investment in updating older technology to take advantage of technology innovations being used by FinTechs
   b. Partner / Collaborate with established FinTechs that make sense for your business (ultimately you might buy them)
   c. Set up an incubator program to invest your financial and intellectual capital into Fintech start-ups

   Seizing the opportunity to change and improve will enable established banks to offer consumers the reliable service they've long enjoyed with the innovative edge they've come to expect.

3. **Distributed Ledgers / Blockchain** – Bill Gates once said that "We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next ten. Don't let yourself be lulled into inaction." Most experts believe that Blockchain, like the internet, will be a fundamental shift in the way we will all do business. There will be a few early adopters in the next 2 years but the potential in the banking, wealth, insurance and securities industry over the next ten years is massive, but don't be lulled into thinking you can tackle this one later. Like TCP/IP (the foundational technology behind the internet and world wide web) the early adoption will take place internally or within trusted circles. For example, the bank of Canada is currently testing a digital currency called CAD-coin for interbank transfers. Over the longer-term companies and potentially entire sections of industries will cease to exist, and new companies will be born. If you've not done so yet, you should aquire a basic understanding of Blockchain and more importantly spend time thinking about how it will affect the way you do business. In addition to internal analysis, talk to your vendors, clients, industry peers and regulatory bodies to get their perspective. The earlier you have a plan to deal with the shift created by Blockchain, the more likely you are to avoid the threats and capitalize on the opportunities.

4. **Customer Experience** – Banks now understand that improving the customer experience is critical to their future success. A McKinsey study found that every 10-percentage point increase in customer satisfaction leads to a 2 to 3 percent increase in revenues.[3] Increasingly this uptick in customer satisfaction will come through digital technology. Customers who are choosing to interact with you will have already done their research. So, chances are the first time you meet your client, they either already know or are very close to deciding what they want to do. This has two major consequences. First, your on-line information, both on your own sites and on sites that compare your products and services to others, need to be complete and accurate. Second, you need to engage your clients with the understanding that they are much closer to deciding than they have been in the past. This means you must have complete and accurate client information and product knowledge at your fingertips. Current personal experience of several our staff, at more than one Canadian Bank, has demonstrated that the client is more knowledgeable not only about their current relationship with the bank but also more knowledgeable about the banks products and services.

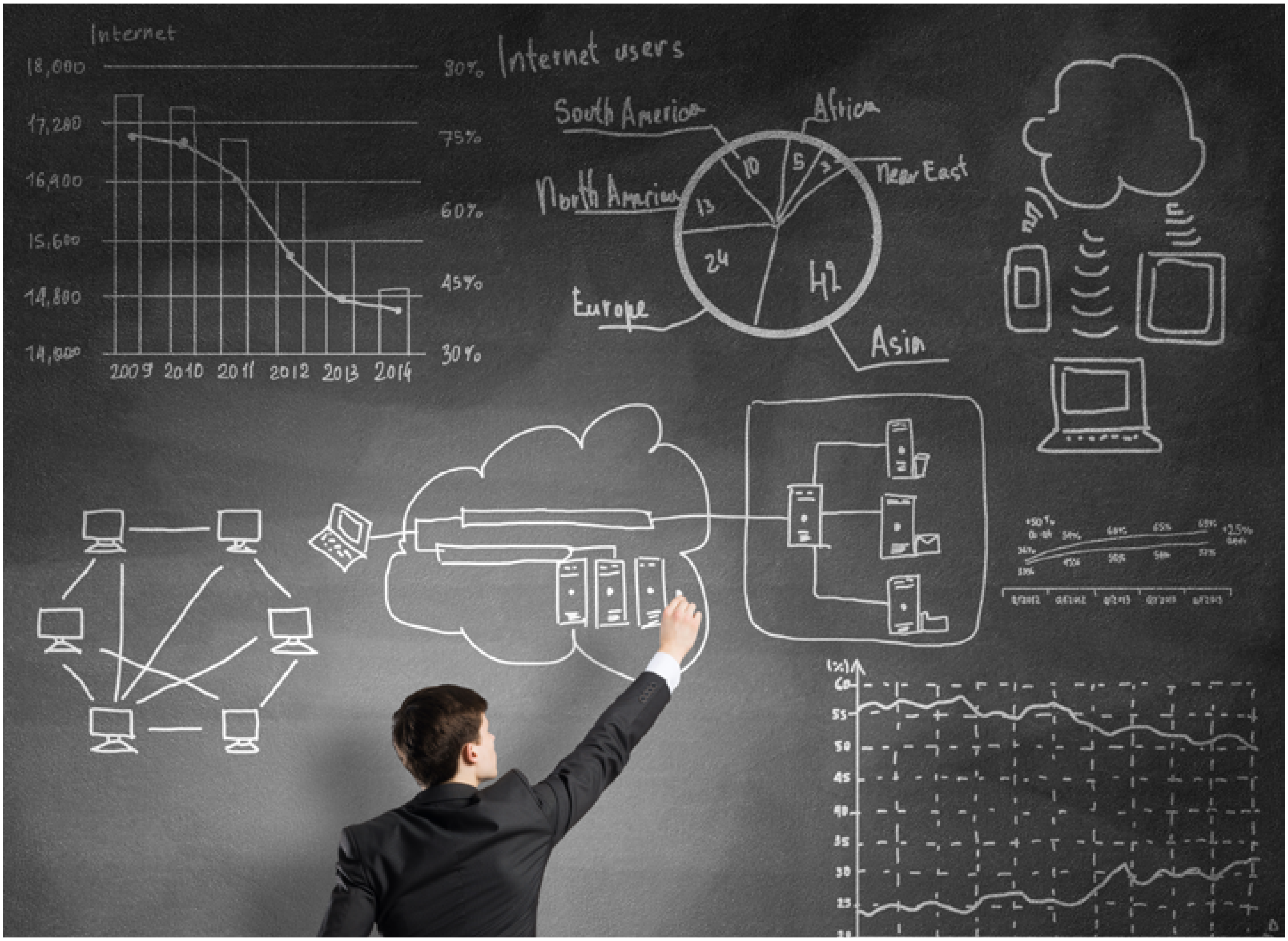
[2] *Blurred Lines: How FinTech is Shaping Services - Global Fintech Report 2016, PwC, pwc.com/fintechreport. PwC 2016.*

[3] *A Brave New World for Global Banking: McKinsey Global Banking Annual Review 2016, McKinsey & Company 2016*

5. **Constant business transformation change is the new normal** – IIn a mature industry such. as banking, is it possible to have a unique strategy? Many are arguing that they cannot. Yes, we have some very interesting FinTechs that are "disrupting" the market, but the larger players simply partner with the disruptive Fintech and brand them as their own (TD and Moven). So, if strategy is not going to separate you from the completion, what will. We believe the answer lies in the execution of the strategy. Unfortunately, study after study shows that most strategy execution outright fails or falls short of accomplishing the desired results. The Bank that can rally its resources and partner with the right firm to help with the execution to consistently get to the market faster will soon put distance between themselves and their competition.

6. **Data** – Financial Institutions across their business spectrums are awakening to the transformative power of data and analytics. They are also coming to grips with the daunting difficulty of the task that lies before them. The challenge of cataloging and categorizing the data at their disposal and then devising rules and processes for using it is being driven by competitive pressure to improve customer interaction, internal decision making and by several regulatory requirements (BCBS 239, IFRS 9, etc.). The task of translating data into tangible value is tough but it must be done and banks have stepped up to the plate with investment in software, new data repositories (data lakes), and organizational changes (Chief Data Officer).

   2017 will bring some new offering and partnerships because of the investment in data in previous years. Financial Institutions will be able to share data across the various areas of their organizations and show the value of cross data seeding, such as retail credit footprints used to understand commercial risk exposure. New data sets will provide insight into customer, employee and institutional behaviors while also provide opportunities to refine offering and provide timely insight. While this is not a new trend for 2017, it is so foundational to the future of the competitiveness of any bank that it must continue to remain a top priority.



7. **Infrastructure Technology** - It doesn't take a clairvoyant to see that digitization, open banking, Payment Services Directive Two (PSD2), and instant payments will be high on the industry's agenda in 2017. The demands from customers, FinTechs and regulation (PSD2, Brexit, deregulation in the USA) will put pressures on traditional banks to transform to fend off threats and exploit new opportunities. It is important that banks' strategy is clear, and more importantly understood, by everyone from management to front of house. Banks will need to transform both within infrastructure technology and customer experience to stay relevant and maintain market share. Three key Infrastructure technology trends to focus on in 2017 are:

    a. **Microservices infrastructure** - Banks will re-architect their technology infrastructure into an event-driven, microservices infrastructure; a challenge for banks with high entropy and customization in their current technology ecosystems. Supported by well-defined APIs, the modular nature of microservices will provide flexibility and adaptability.

    b. **API ecosystem** - Banks will also optimize their processes to drive operational efficiencies and make use of the new infrastructure. Within process optimization, processes will need to be mapped, while bottle necks and systems will need to be identified and constrained to ensure continuous flow (refer to the theory of constraints [TOC] for further reading).

    c. **Process optimization and DevOps delivery** - Finally, banks will also adopt DevOps delivery of automation and continuous delivery / integration to reduce lead time of change. This is essential if banks are to compete with the FinTechs in terms of cost per change, and will ensure they can deliver value to the customer in a more efficient and predictable way. To enable DevOps we will see more banks moving their core banking to the cloud, as Metro Bank has done in 2016.

ABOUT WELLINGTON

At Wellington, we understand that most business transformations fail. Our business model is built with one single purpose: The successful implementation of your strategy.

We pride ourselves on having a long list of clients that understand that first and foremost we are there to make them successful as they implement their strategies and to prepare them to work without us when the implementation is done.

For more information e-mail us at Info@WellingtonCG.com

ABOUT THE AUTHORS

Brian McConnell
President/Founder

Brian has built Wellington on a foundation of integrity, professionalism and passion for building and managing team to solve complex business problems. In helping large and medium size enterprises effect change over the past 25 years, Brian believes Wellington thrives when it successfully completes projects and, at the same time, helps to strengthen a client's people and organization. It is an approach that saw Wellington rank as one of Profit Magazine's HOT 50 companies and landed them on the Profit 500 in 2015 and 2016.

Michael Nolan
Chief Imagineer

Michael is Wellington's Chief Imagineer. He takes large complicated business strategies and turns them into practical real world solutions that deliver business results. With more than 15 years of experience in financial services and consumer products sectors around the world, Michael brings a passion for effecting change and driving business transformation. Over the past 10 years, he has helped deliver complex projects that have transformed business and helped them embrace new ways to achieve success.

WELLINGTON
Consulting Group

C 416.564.5330 O 416.901.3393 | info@wellingtoncg.com | wellingtoncg.com