KPMG

Frontiers in Finance

Issue #61

Reshaping financial services

On the cover

Harinder Takhar, Paytm Labs, page 6

Featured interviews

Voices on 2030, page 13
Ranjana Clark, MUFG, page 22
Harit Talwar, Goldman Sachs, page 35

October 2019

home.kpmg/frontiersinfinance

Letter from the editors

Big changes; big opportunities

If change is the only constant then transformation is the only option. And so it is for Financial Services executives around the world. Massive changes — in business models and operating strategies, in regulatory environments and customer expectations, and in technologies and competitive advantages — are sweeping across the marketplace. On top of this, there is increasing cost pressure due to low interest rates and increasing compliance costs. Banks, asset managers and insurers are all looking to seize on the opportunities.

This edition of *Frontiers in Finance* explores some of the great challenges now facing Financial Services executives as they strive to balance their short term objectives against their longer term transformation imperatives. As organizations move to re-evaluate, re-imagine and re-define their business models and operating strategies, this edition offers some insights to help executives create and execute sustainable transformation in an ever-changing world.

The articles in this edition are concentrated around three main drivers of change: the desire for efficiency; the shift to digital; and the evolving regulatory environment. Yet the lessons being shared by the banking, asset management and insurance leaders interviewed for our articles are broadly applicable, regardless of the kind of pressures for change your organization is facing.

Some of our articles — such as our cover story with Paytm's CEO or interviews with MUFG's Head of Global Transaction Banking or with the Head of Global Consumer Business, Goldman Sachs — offer deep insights into the pace and scope of the change that is now underway across the industry. Others, such as our articles on the changing nature of M&A, the introduction of IFRS17 and drive for improved operational excellence, take a focused view of the new strategies at play within key areas of the financial services organization.

What this edition of *Frontiers in Finance* clearly shows is that the leaders are not waiting for clarity on what exactly the future may hold; they are taking bold steps and making radical changes to their businesses to find and create their own opportunities for transformation and growth. This edition provides practical ideas on how they are doing it.

On behalf of KPMG's global network of financial services professionals, we would like to thank all of the executives and business leaders who took the time to share their thoughts, experiences and insights with us.

If you would like to learn more about the issues raised in this edition of *Frontiers in Finance*, or to discuss your own unique transformation opportunities, we encourage you to contact your local KPMG member firm or any of the authors noted in this publication.

Mads Raahede
Partner
KPMG Advisory
Financial Services Lead
KPMG in Denmark

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Contents

Chairman's message 4

Cover story
Paytm: Solving problems to create opportunity 6

Creating efficiencies

10 What ails European banks?
Exploring the challenges facing the European banking sector, and ways in which to transform.

14 Capturing the benefits of simplification
Simplification as a vehicle to a faster, leaner, more agile business.

18 Accelerating transformation: Beyond signing the deal
A new way to look at, and achieve value from, M&A and deals.

13 Voices on 2030
The Future of Financial Services
Video interviews with leading and start-up financial institutions on the future of the industry — interconnected, collaborative, frictionless.

Digital models take hold

22 Agility with discipline: Transforming MUFG's Transaction Banking business
Ranjana Clark shares her views on digital disruption in banking and four pillars for success.

26 Connect to compete: Delivering the next-gen target operating model
What will the next-gen target operating model look like?

30 Does banking's future outweigh its past?
New business models will halt the band-aid approach to legacy systems as banks look to new architecture that is digital to the core.

35 Spotlight: Goldman Sachs breaking new ground with Marcus
A discussion with Harit Talwar, Head of Global Consumer Business, Goldman Sachs, on starting a digital bank.

36 Flexibility for growth: Operational excellence in an era of digital disruption
What will it take to achieve operational excellence in today's insurance industry?

Compliance-driven transformation

40 Next-generation banking technology and tax implications
As operating models change, tax teams in traditional banks must broaden their horizons.

46 AI offers the smartest solution for transition to RFRs
LIBOR transition presents the opportunity to transform a manual and error-prone process. Are you ready?

50 Tax, transfer pricing and transformation: What Asset Managers may be forgetting
Tax-savvy asset managers undertake five key activities to ensure they aren't missing opportunities or creating new risks.

54 When opportunity comes calling: Using the deferral of IFRS 17 wisely
Five critical commercial and operational opportunities for insurers from the delay to IFRS 17.

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Finding the fortitude to transform

Financial service executives know they need to get serious about transformation if they want their organizations to survive. Now they just need the organizational fortitude to make it happen.

James P. Liddy
Global Chairman, Financial Services
KPMG International
Partner, KPMG in the US

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

As an industry, we have spent years talking about the need for radical transformation. Yet, notwithstanding a handful of truly innovative leaders, the reality is that little has actually changed in the way most financial services firms operate.

Sure, over the past decade, many key processes have been digitized and automated; some exciting new channels and innovative tools have been added; new business models and operating models have also been adopted.

What we have not yet seen, however, is widespread appetite — or, more importantly, competition — around full-scale transformation programs. Instead, we have seen smaller-scale efforts and initiatives, largely aimed at achieving cost cutting and efficiency objectives.

Start with a healthy appetite

The reality is that, until today, few executives have seemed willing to risk their careers on a wholesale organizational transformation. Yet my conversations with banking, insurance and asset management leaders around the world suggest that the mood is starting to shift. Executives and organizations are starting to find the intestinal fortitude to do what they know they must.

Consider this: In KPMG International's recent global survey of financial services CEOs,[1] 22 percent of respondents admitted they were primarily driven by short-term growth pressures. But 47 percent said they were more motivated by much longer-term objectives such as upholding the values of customers, making an environmental and socioeconomic impact or innovating the business model.

In part, this reinvigorated commitment to transformation is being driven by concerns around competition. Executives are starting to realize that the more innovative brands are starting to look and act quite unlike a traditional bank. They also understand their customers no longer want the same types of financial services they did just a few years ago. And that is leading many financial services executives to reconsider where they want to position themselves in the go-forward economy.

While most executives recognize that transformation is now an absolute imperative, my discussions with them suggest that many are worried they may not have the people, processes or organizational agility to be able to do what is necessary to compete. They want to progress, but they are concerned they may not have the right foundations for success.

[1] Global CEO Outlook 2019, KPMG International

Add the right ingredients

My view of the banking, insurance and asset management industries suggests there are five key areas where financial services executives will need to focus on if they hope to have the organizational capabilities, capacity and fortitude required for sustainable change.

Talent: One of my greatest concerns is whether today's financial services workforce has the skills and capabilities required to be successful as the workforce of tomorrow. Financial services firms are full of people with really good production capabilities; what they often lack are innovative thinkers at the operational level. The leading firms are reorienting their workforces to focus on recruiting and developing employees who are data-driven, analytically inclined, attuned to the technological change in the marketplace and keenly aware of the shifting needs of their customers.

Culture: Financial services firms will need to start delivering the types of products and services their customers require. And CEOs recognize they will need to foster a much more innovative and entrepreneurial culture in order to achieve that. In fact, in our survey of financial services CEOs,[2] 84 percent said it was critical to ensure their employees feel empowered to innovate without worrying about the negative consequences; just 56 percent believe their organization has a culture where failing in pursuit of innovation is tolerated. Cleary, more must be done to create an innovative culture.

Security: In today's financial services industry, providing a safe and secure environment is often seen as table-stakes by customers. But that does not make it any less of a priority. It is no longer good enough to manage cyber events when they occur. Cybersecurity needs to be a core competency within the organization — one that customers can trust. Our survey of financial services CEOs indicates that almost seven in 10 organizations see information security as a strategic function and a potential source of competitive advantage.

Customer focus: Perhaps not surprisingly, around two-thirds of financial services CEOs agreed they will need to significantly improve their understanding of customers going forward. The problem is that today's customers lack filial loyalty to historical institutions. They want what they want, when they want it, and they don't really care who they get it from. That makes it extraordinarily difficult to retain customer loyalty and deliver on customer needs on a consistent basis. The leading brands are applying a wide range of technologies, partnerships and models to improve their understanding of their customers. And they are communicating with their customers in ways that enhance convenience, build loyalty and inspire trust.

Efficiency: Building a new organization on top of inefficient foundations is not the key to successful transformation, particularly in a time of increased market volatility and uncertainty. While many banks are currently focused on cutting out costs and improving bottom-line financial performance, the leading brands are those that are using the opportunity to improve organizational agility, encourage flexibility and enhance overall resilience. They view large-scale transformation as a way to reduce the day-to-day managerial burden of the organization so that decision-makers and employees can focus on creating value.

I'll have what they're having

As this edition of *Frontiers in Finance* clearly illustrates, the path to transformation need not be fraught with risk. Indeed, this publication is filled with stories of banks, insurers and asset management organizations that are taking transformation head-on and finding ways to turn their risks into opportunities for competitive advantage.

What differentiates the leaders in this publication from the rest of the industry? In my opinion, it's that they had the intestinal fortitude to take the first step on the road to fundamental transformation. ■

Contributor

James P. Liddy
KPMG in the US
E: jliddy@kpmg.com
Jim is the Global Chairman, Financial Services, KPMG International. He also leads KPMG in the US' Financial Services practice. Prior to assuming his current roles, Jim served as Americas Leader, Global Financial Services.

[2] Global CEO Outlook 2019, KPMG International

Chairman's message
Cover story Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

Cover story

Paytm: Solving problems to create opportunity

Paytm has revolutionized India's payment environment, and at the same time is creating massive opportunities for banks, insurers and asset managers.

Harinder Takhar, Paytm Labs Inc.

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

If you own a smartphone and spend any time at all in India, there's a good chance you have the Paytm app on your home screen. Most people living in India do: They use it for everything from buying groceries and paying school tuition fees through to selecting insurance products and getting loans.

Adoption rates have been amazing — even by today's standards. The company was founded less than a decade ago. Yet, today, more than 7 million merchants across India use its QR code-based mobile payment system. The app has been downloaded more than 100 million times; the number of registered users has jumped from just 11 million in 2014 to more than 420 million today. Revenues soared to US$480 million in 2018.

Finding the source of the pain

Paytm's core business has always revolved around payments. But the company sees itself more as a 'problem solver' than a bank or a tech firm.

"Our approach is to identify the pain points for customers and then solve them really, really well — better than anybody else can," said Harinder Takhar, former CEO of Paytm in India and current CEO of Paytm Labs Inc. in Toronto, Canada.

The first pain point the company solved for India's consumers was around pre-paid mobile top-ups: Paytm allowed customers to top their accounts up instantly on their phones rather than going to a store, buying a top-up card and struggling with an extraordinarily long password. That allowed it to build brand awareness and a loyal customer base.

Fixing the system

The company's next objective was much more ambitious — to make India's payment system more inclusive, more efficient and more reliable. It was an audacious goal.

When the company was founded, the vast majority of India's population had no access to formal banking services at all. Those that did have bank accounts often struggled to use the instruments available to them. Less than 2 percent of the population had a credit account. Cash and cheques were the norm.

Harinder and Vijay Shekhar Sharma (Paytm's founder) realized this was a problem they could help solve. In 2014, the company introduced the Paytm Wallet. "Allowing customers to store money in their virtual wallet meant that Indian consumers could now make transactions using digital money," noted Harinder. "It was a game changer."

A super-app in the making

Over the next few years, Paytm added dozens of new use cases for its technology. Paytm's mobile payment platform was, for a time, the only payment method accepted by Uber in India. It partnered with a wide range of transport, utility and entertainment companies to create digital payment systems. And it launched an e-marketplace where customers can find almost any item or service available in India, often at a discounted rate.

"Our typical customer comes to us because of a needs-based reason — they need to take a bus or pay a bill — but over time, they start to discover that we can actually help them solve a much wider range of needs, from paying their kids' tuition fees through to finding a great deal on an item they really need," added Harinder.

Users of Paytm's app have access to a stunning array of goods and services. At last count, the platform boasted more than 15 million merchants across more than 200 different categories of service.

Many of those categories involve what is traditionally seen as financial services. For example, Paytm offers customers the ability to insure a wide range of purchases — including bus trips and movie reservations. It has a 'fractionalized asset ownership' product that allows customers to pay as little as 1 rupee for a fraction of a stock or asset. Its Paytm Gold Savings provides customers with a long-term savings vehicle.

"Users of Paytm's app have access to a stunning array of goods and services. At last count, the platform **boasted more than 15 million merchants across more than 200 different categories** of service."

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Creating markets

While it may seem as if Paytm is taking on the traditional banking system, it is not. In fact, as Harinder is quick to note, Paytm is providing a pivotal intersect between India's population and the established banking order.

"We see Paytm as a way to bring half a billion unbanked Indian consumers into the formal banking system," noted Harinder. "People who work in the informal economy or in rural areas have pretty much the same financial services needs as everyone else. But they are often left out of the system because they are not on anyone's radar."

Indeed, given its rapid rate of growth and adoption in India, the app is quickly becoming the top distribution channel for financial services in the country. Through the merchant store, users can access a wide range of traditional financial products, from home and life insurance policies through to investment assets and products.

"We help our users discover the products and services they need," added Harinder. "The traditional banks and insurers love the fact that we have access to people they simply could not reach before."

Driving customer acquisition

Yet Paytm's goal is not just to sell products to users. It's also to help users achieve their own goals. That often means helping them establish themselves in the mainstream economy.

In a cash economy, small businesses and merchants are often overlooked by the traditional banks due to a lack of reliable records and credit history. Paytm helps to solve that pain point by using its technology to create a robust and reliable view of its business users — their cash flows, their customers, their daily balance sheet status and so on. And they use that view to help the business establish their credit-worthiness.

> "… Paytm's goal is not just to sell products to users. It's also to **help users achieve their own goals.** That often means helping them establish themselves in the mainstream economy."

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

"More often than not, we'll then help that merchant find a bank that wants to work with them based on the data we have collected," added Harinder. "We are helping banks acquire new, credit-worthy business and personal customers that simply didn't exist in the mainstream economy before the digitization of payments."

Out of India

So what is Harinder — Paytm's first CEO and long-time friend of founder Vijay Shekhar Sharma — doing at Paytm Labs in Canada? Solving more pain points, of course.

The company has been looking for opportunities to use its technology to address payment opportunities outside of India. Last year, the company partnered with Japan's Softbank and Yahoo! Japan to launch a new digital payment system in Japan.

"When we launched PayPay in Japan, about 87 percent of personal retail transactions were happening with cash," said Harinder. "Japan is such a large economy with significant consumer spending. The opportunity to apply our technology to help solve that problem was obvious."

Paytm also sees significant opportunity in Canada where the organization has already developed a consumer app and is now investing into its merchant-acquiring capabilities to create more value for customers. The Lab in Canada is also where Paytm develops and tests many of its investments into new technologies.

Capital and commendations flow

Paytm's ability to solve problems with technology has made it a darling of technology investors and pundits. The company has won the *FT Future of Fintech Award* and *Forbes' Outstanding Startup of the Year Award.*[1] Paytm's founder was featured in Time's 100 Most Influential People (2017)[2] and Harvard Business Review did a case study about Paytm titled, *Paytm: Building a Payments Network (2017).*[3]

China-based Alibaba Group and Japan-based SoftBank have both made significant investments into Paytm over the past 10 years. So, too, have Western investors such as Sapphire Ventures and Berkshire Hathaway. As of the start of last year, the company was valued at more than US$10 billion.

"Investors like that we solve problems. And, since we do it better than anyone else, our customers keep coming back," noted Harinder. "We still have significant room to grow in our home markets and a world of amazing opportunities overseas."

Ready to partner

From his vantage point, Harinder is confident that the current state of disruption in financial services will continue for the foreseeable future.

"Consumers clearly expect the way they discover and use financial services to fundamentally change," he noted. "We can't expect things to continue to happen in the same old ways. As an industry, we need to keep up with expectations."

Harinder sees Paytm as the technology geek that understands what customers really want and need. And they are able to move faster than most traditional financial services organizations to deliver on those expectations. The opportunities for partnerships are immense.

"We look forward to working with all sorts of banks, lenders, insurance companies and asset management firms to bring these new technologies and customer interfaces to market," added Harinder. Expect to find the Paytm logo on your smartphone soon. ■

Contributors

Harinder Takhar
CEO — Paytm Labs Inc.
Harinder is the CEO of Paytm Labs Inc., the Toronto-based research and development division of Paytm. In his previous role, Harinder led Paytm as its first CEO in India when Paytm launched in 2011. At Paytm Labs Inc., he is responsible for two key objectives: building Paytm's machine learning and big data technologies and growing Paytm's presence in North America.

Amarjeet Singh
KPMG in India
E: amarjeetsingh@kpmg.com
Amarjeet is a Senior International Tax and Regulatory Partner with KPMG India specializing in the area of internet commerce and start-ups in the Fintech space. He is a qualified Chartered Accountant and has advised a number of Corporates in relation to inbound and outbound investments from India. He is also the Lead account partner for Paytm in India.

[1] https://paytm.com/about-us/
[2] https://blog.paytm.com/vijay-shekhar-sharma-named-to-the-2017-time-100-list-of-most-influential-people-in-the-world-1d4f5cffe696
[3] https://www.hbs.edu/faculty/Pages/item.aspx?num=52175

Chairman's message
Cover story Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

What ails European banks?

Francisco Uria, KPMG in Spain

Making generalizations about European banks — as about North American or Asian banks, for that matter — is always rather unfair. Each region, each entity, each business model faces wildly diverse circumstances, such as the degree of progress made along the path of digital transformation, the regional setting or the range of products and services on offer.

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Nevertheless, there are aspects common to most banks that indicate that European banks are having a very difficult time of it.

Objectively, most European banks are experiencing problems of lack of profitability, the origin of which is the subject of discussion.

On the one hand, banks and the associations that represent them claim that the source of the problem is essentially the European Central Bank's (ECB) policy of lax money and negative interest rates that, as we recently learned, are set to continue for some time due to the weakness of the eurozone economy. ECB spokespersons at the highest level have repeatedly contested this claim, arguing that the real source lies in an excess of installed capacity and the attendant need for countries that have not yet undertaken restructuring and streamling processes, to do so — and soon.

Combined with this perceived lack of profitability comes the pessimism of analysts and institutional investors about any improvement in the short term, given that the lack of economic growth can slow down the rate of growth of credit demand.

Sure enough, the global economic context and, particularly, trade tensions between the US and China, on the one hand, and between the US and Europe, on the other, are affecting European economic growth and slowing it down, as both the European Commission and the ECB have previously stated. Obviously, other political factors such as Brexit and the uncertainty it has created have also played a part in the lacklustre performance of the economy compared to that reported some months ago.

Against this backdrop, the general outlook for the European financial sector is one in which the beneficial effects of digital transformation on efficiency are still nowhere to be seen. New players (singularly, the Big Techs) are moving in, affecting areas of business that have traditionally buoyed up the profits of financial institutions. Nor will achieving revenue growth be easy. In all likelihood, only by slashing costs, reducing the number of branches and making staff cuts will institutions be able to make a positive contribution to profit and loss. This scenario has dealt a considerable blow to aggregate stock market capitalizations as was seen when the closing bell rang at the end of 2018.

Regulation has not helped. In recent months, the individual levels of MREL (minimum requirement for own funds and eligible liabilities), which represent a sizeable burden for small and medium-sized entities that are less accustomed to raising finance on capital markets, have gradually come to light.

On 2 July 2019, the European Banking Authority quantified the aggregate impact of the new Basel III capital adequacy requirements, which mainly affect the larger banks, at Euros 135.1 billion.

Faced with new competitors, heightened regulations and greater capital adequacy requirements, European banks would do well to respond with a combination of the following strategies:

1. **Diversification of revenues**, reinforcing positions in asset management, insurance and private banking.
2. **Efficiency improvements** through the implementation of effective strategies aimed at cost cutting and streamlining of operations.
3. **Monetization of technological investments** such that the **'digital dividend'** derived from the transformation that has already taken place can materialize.
4. **Use of market opportunities** to shed non-performing asset portfolios (NPLs), in order to comply with the repeated requests of the regulator and the **supervisory bodies**, and entry into agreements with industrial partners with a view to developing specific **business segments** (consumer credit, loans to SMEs, asset management, depositary services and custody, payments, etc.) in anticipation of the arrival of new competitors.

Chairman's message
Cover story
Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

In the new environment, with old and new competitors threatening the profitable areas of the bank, and with legacy systems that require much more than a simple patchwork update, the investments traditional banks need to do are massive. But it would be a mistake to think that the change is only related to technology.

On the contrary, it is not just, or mainly, about taking advantage of what technology can offer. It is a question of undertaking an integral transformation of the business model of the entities and to rethink their strategy. The key question to respond is how the banks will create and monetize value for their clients and the society as a whole in the future.

This is also a critical point for many European banks: how to position themselves in the marketplace. They should carefully select their target markets, business and clients and also decide if they can make this work alone or if they need some partnership and with whom.

Aside from these strategic decisions, there is also the issue of consolidation. Naturally, in the above context, an increase in size can be a means (though not the only one) to achieving efficiency gains and boosting profitability. One should be aware that such gains usually occur after a certain period, and that initially, at a time when the sector is experiencing difficulties, the profit and loss statement (P&L) may be adversely affected. On the other hand, these are mergers that would make sense from an industry perspective and that, given the characteristics and position of the entities, would bring about the creation of solvent, competitive institutions.

Consolidation also raises the question of whether it should be cross-border within Europe or whether domestic integration should prevail.

Although the ECB, among other legitimate voices, has promoted cross-border mergers, there are several reasons why, with exceptions, these have not materialized for banks in the eurozone for some years, even within the scope of the Single Supervisory Mechanism. The main reasons for this are limited expectation of drumming up business and modest profitability, as well as the uncertainties that a merger always brings with it.

On the other hand, regulatory fragmentation clearly persists in such delicate areas as consumer protection, deposit insurance, the insolvency regime, etc. This fragmentation means that banks do not have complete freedom of movement, even within the eurozone.

It is discouraging to think that it has not been possible to make progress in the creation of a European deposit insurance scheme (EDIS), despite the time that has elapsed since the political agreement was reached to build a banking union in the eurozone.

Furthermore, this fragmentation, in the case of a cross-border merger, prevents synergies from being captured as they are in a purely domestic context, so any potential efficiency gains are greatly attenuated by the limited expectation of an increase in turnover. Risks of every type are inherent to the integration process in which cultural, linguistic and other factors also come into play. One might well ask, why such insistence in this regard by the ECB?

For all of the above reasons, and notwithstanding the view that integration processes between credit institutions from different countries can be beneficial, the most prevalent view is that both in markets where financial sector restructuring and consolidation are still pending, and in markets where sizeable mergers have already occurred but where other transactions may still be in the offing, the most typical form of consolidation will continue to be, at least for some time, consolidation among domestic entities.

In conclusion, the European financial sector continues to struggle in a highly complex scenario where limited profitability, a new wave of regulation and difficulty in gathering profits through efficiency gains from technological investments (digital transformation) in the short or medium term, create a situation in which the only strategy within reach appears to be cost cutting. There are not many elements that would lead us to believe that the situation is going to improve in the near future. ■

Contributor

Francisco Uria Fernández
KPMG in Spain
E: furia@kpmg.es
Paco is a Senior Partner with KPMG in Spain and the EMA Head of Financial Services, Banking & Capital Markets. A qualified lawyer, he holds a Doctorate of Law (Banking Regulation) from the Complutense University of Madrid. Paco has also authored a number of publications mainly related to financial regulation.

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Voices on 2030

The Future of Financial Services

The digital disruption of financial services is well underway, from the explosion of fintechs to the opening up of financial services. But what will the industry look like when the dust has settled? KPMG spoke to prominent figures from fintech to big banks, insurers and asset managers to software providers and social enterprise — who shared their vision for the future of financial services.
kpmg.com/voices2030

"In 2030, the whole survival game is: are you in the right ecosystems?"

Piia-Noora Kauppi
Managing Director,
Finance Finland

"Speed and adaptability is the new competitive battleground."

Claire Calmejane
Risk Product Owner,
Lloyds Banking Group

"In 2030, the question will be how much does the financial sector contribute to sustainable development."

Sasja Beslik
Sustainable Finance Expert

"Be ready for an open ecosystem."

Sopnendu Mohanty
Chief FinTech Officer,
Monetary Authority of Singapore

"With open insurance you will have the ability to connect services and fetch data to make really interesting services for the end customers."

Kristin Linmark
CIO, SPP

"Finance will become more accessible and frictionless."

Nick Middleton
Executive Director,
UBS Wealth Management,
Head of UBS SmartWealth UK

"Our platform is going to allow us to do more intelligent risk management."

Ning Tang
Founder and CEO, CreditEase

"Insurance will be more predictive in 2030."

Blair Turnbull
Managing Director,
Digital & Retail
UK and International, Aviva

"All these ecosystems will be totally frictionless for a customer."

Sébastien Marotte
Europe, Middle East and Africa leader,
Google Cloud

"Data analytics will form the core of your financial crime unit by 2030."

Colin Bell
Group Head of Financial Crime Risk,
HSBC

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Capturing the benefits of simplification

Hessel Verbeek, KPMG Australia
Ian Smith, KPMG in the UK

Financial services executives know they need to simplify their organizations to support sustainable growth and to adapt to secure a successful tomorrow. But are they approaching simplification in the right way to thrive in the longer term?

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Everybody knows that most financial services organizations, apart from the most recent disruptors, are far too complex. There is a huge amount of legacy that is impairing the ability to adapt and meet the rapidly evolving needs, requirements and expectations of customers. Customers want convenience, efficiency, information, education and seamless, frictionless experience across multiple channels at a time that suits them. They expect rapid deployment of new tools and innovations, which are not just relevant, but also engaging. They are looking for transparency and trust.

Simply put, they want their banking, insurance and investment transactions to be simple. And most of today's financial services organizations are anything but simple.

Nothing simple about it

It's not for lack of trying. Most financial services firms are now executing on dozens — sometimes hundreds — of different initiatives that, ultimately, should simplify the business. Some of these efforts represent unprecedented change agendas, with all of the associated bear traps. KPMG member firms are seeing some banks and insurers replace key elements of their core systems and consolidate their ancillary systems in an effort to rationalize their IT estate, modernize their capabilities, reduce costs and, at the same time, provide the capabilities to adapt and evolve their business models to secure future growth.

Others are working on more focused pain points and complexities. Some are rethinking the fundamentals of their products and their wider portfolio of products. Others are examining their current financial, business and operating models, and outsourcing arrangements. Many are working on simplifying specific client and risk pain points like KYC, claims and remediation.

Simplification is as much about creating and applying the capabilities to support improved customer experiences, innovative propositions, speed and automation, scalability and increased visibility as it is about cost efficiencies.

However, dig into the investment case behind many of these initiatives and — interestingly — most are founded on return and efficiency metrics such as Net Present Value (NPV), Internal Rate of Return, and cost and head count reductions. Of course, these are important metrics: Shareholders expect returns and competitors are differentiating on cost and efficiency, but these should not be the only drivers.

Go beyond efficiency

Cost efficiency is far from the only benefit that can be accrued from simplification. Simplifying what you do today doesn't necessarily set you up for future success if the market is changing rapidly and business models are being disrupted. Simplification also has to support changing what you do tomorrow.

A simplified architecture can also support innovation, for example, developing, testing and launching new propositions and getting to market faster and cheaper. For example, a simplified core banking system would allow firms to make upgrades and integrate new technologies in a fraction of the current time. Entering into new alliances and partnerships will be more feasible and viable for a simpler business.

It should also support scalability, reduce future cost, increase the speed of change and provide improved risk management and resilience. Straightening out the spaghetti bowl of systems and processes also creates better visibility which, in turn, should allow financial services firms to get much closer to customers, improve operational resilience and control over performance, and better understand and anticipate risks. Simplified control environments and processes should help organizations adapt quickly to future regulatory changes.

Perhaps most importantly, simplification of the business allows decision-makers to focus their scarce capital on investments that actually matter to the business and its customers. Just imagine the clarity of mind that would come from overseeing a vastly simplified financial services operation. IT budgets would be focused,

> “We are seeing some **banks and insurers replace key elements of their core systems and consolidate their ancillary systems** in an effort to rationalize their IT estate, modernize their capabilities, reduce costs and, at the same time, provide the capabilities to adapt and evolve their business models to secure future growth.”

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Five steps to simplification

01

Clarify the financial organization's strategic focus (such as purpose, role, client focus, experience requirements, value, ease, innovation) and make clear choices around competitive positioning. This will drive strategic choices around the organization's architecture and operating model.

02

Choose a direction for the business architecture (such as the assembly of customer journeys, distribution and operations). Many financial institutions are organized along product and channel lines, giving rise to silos, which need to be broken down.

Typical considerations for business architecture include:

- customer journeys, segments and product needs
- sales and service approach (e.g. by channel vs. integrated) and incentivization (e.g. profit or cost centre)
- multi-brand management and fulfillment
- high level systems architecture
- operations and technology, including centralized services between divisions.

03

Determine which activities are strategic and provide a competitive advantage, given the organization's agreed focus in the first step. This will drive choices around which activities should be retained in-house and which could be outsourced.

04

Assess the simplification options for the organization's activities in line with its strategic focus, its business architecture and the (strategic) nature of its activities. Four main options should be considered for each activity:

- **CoE creation:** Leverage current capabilities with potential for high performance. This is likely to be the adoption of a current Centre of Excellence (CoE) for the wider organization (e.g. migrating all secured and unsecured consumer credit assessments to the state-of-the-art mortgage credit assessment platform).
- **Transformation:** Transform existing assets/ capabilities that are not restricted by legacy issues (e.g. HR management supported by a newly implemented cloud-based ERP system).
- **Development for replacement:** Build a new unconstrained capability to take over activities with too many legacy issues to be transformed (e.g. full replacement of firmwide data and analytics functions by a central hub).
- **Third-party solutions (including partnering/ outsourcing):** Consider third-party solutions for non-strategic activities that are not high performing. Decisions should be based on reduction of complexity, organizational rigidity or risk, rather than on productivity alone.

05

Develop the simplification road map, taking into account various dependencies. The road map will be bespoke for every organization, given their vast differences in starting position, strategic activities and simplification options. In order for the change to be delivered, the following must be aligned across the business — clear roles and responsibilities and sponsorship to drive and ensure ruthless execution.

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

innovation investments would be highly targeted, and waste and duplication would be eliminated. Every investment dollar would count towards the long-term health of the organization.

Making the case

Financial services executives are well aware of the benefits of taking a broader view on the case for change, beyond cost. They know that improved capabilities, agility, risk management and investment prioritization is inherently valuable to the organization over the long term. But they often aren't sure how to quantify them and reflect them in the investment case.

That is not surprising. What value do you put on getting an as-yet-undefined product to an as-yet-undefined market in an as-yet-undefined space of time? How do you quantify the value of decision-making clarity in financial terms? What does a happy and satisfied customer look like on a balance sheet? These are not simple calculations to make.

The problem is that the 'harder' benefits of the investment case — the cost and risk considerations — are very clear. Simplification often requires organizations to break the status quo. Sometimes that may mean investing into new systems, tools or capabilities. It may require new financial, business and operating models and ways of working. Investments will be high and no amount of head count reduction will balance the equation in the short term.

Somewhat counter-intuitively, many executives are also worried about the risk of removing the complexity. They recognize that some of their current systems, processes and models are stuck together with the IT equivalent of duct tape and glue. Nobody really knows for sure what the unintended consequences are when ancillary systems are shut down. The challenges and risks of major transformations are significant.

Take it from the top

Simplification should never be the primary objective in and of itself. When simplification is the only objective, investments in improvements and innovation will get penalized. But that only reinforces the status quo.

While assessing and quantifying the non-cost benefits can be challenging, it is not impossible. We help banks, insurers and asset managers do it all the time. It does need a strategic mind-set and a more holistic assessment of the broader and longer-term benefits that simplification can deliver, including support for future growth. Where the NPV isn't adding up but the full benefits are obvious — this is worth the effort.

Instead, financial services organizations need to see simplification as the vehicle to get to a faster, leaner, more agile and more customer-centric future, supporting new business models to deliver long-term, sustainable and profitable growth. That will be the only way to thrive in tomorrow's uncertain environment.

We believe that the best way to make sure that simplification is given heavy weighting is by ensuring that simplification is an inherent enabler to the core strategy; embedded and driven from the top down and shared across all divisions, functions and markets. With clarity of objectives underpinned by a strategic decision to simplify, the question of how to quantify all the simplification benefits becomes less sensitive. ■

Contributors

Hessel Verbeek
KPMG Australia
E: hverbeek@kpmg.com.au

Hessel leads KPMG's bank strategy practice in Australia. With more than 20 years' experience in strategy consulting, Hessel helps organizations make the necessary but difficult choices required to remain competitive in today's rapidly changing industry. He believes that the sector needs to focus on simplification of its strategies and operations in order to best serve its customers and other stakeholders.

Ian Smith
KPMG in the UK
E: ian.smith@kpmg.co.uk

Ian is a financial services strategy Partner based in London. He specializes in helping banks, insurers and asset managers understand how markets are evolving and identify future winning business and operating models to secure sustainable growth. Ian has worked extensively with many leading financial services organizations on these complex and critical issues.

Chairman's message
Cover story
Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

Accelerating transformation:

Beyond signing the deal

Ram Menon, KPMG in the US
Giuseppe Latorre, KPMG in Italy

Financial services firms are looking to inorganic growth opportunities to accelerate transformation. And that puts M&A and corporate development teams on the front line of the transformation strategy. Are they ready?

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

As the pace of disruption picks up speed and traditional sources of value start to shift and dissolve, many financial services executives recognize that 'more of the same' is no longer a sustainable strategy in the long run. Transformative changes must be made. They must be made quickly, and they must be executed strategically.

The most prudent also understand that the type of transformative change they require to compete in today's rapidly evolving industry can't be achieved through organic growth strategies alone.

That has led many financial services CEOs to look outside their organization for new sources of inspiration to achieving their transformation objectives. In fact, in a recent global survey of financial services CEOs conducted by KPMG International,[1] 46 percent said they now see inorganic growth strategies as the fastest way to transform their business and operating model.

The sprinters have left the blocks

Many have already started focusing on executing the type of acquisitions, divestitures, alliances and partnerships that they hope will enable them to achieve their transformation objectives. Our view of the market suggests that the insurance industry — generally speaking — has been relatively more active in this regard; many of the larger banks are only just starting to catch up (particularly around the payments part of the business).

Yet KPMG professionals' conversations with financial services executives suggest that many of those at the forefront are increasingly finding themselves struggling to convert their desire for transformative deals into actual results and value. Several deals and partnership agreements are being contemplated or have been signed. But, for the most part, not much has changed from a transformation perspective. Frustration levels are rising, as post-deal transformation remains a challenge.

Our view suggests that banks and insurers could be doing more to ensure their transformative deals actually enable the desired transformation, and deal execution is geared towards maximizing and accelerating synergy capture and value creation.

Taking a new view on value

The problem, in our experience, is that far too many banks, insurers and asset managers continue to approach transformative deals and partnerships as if they are no different from the deals they have done in the past.

The reality is that they need to be approached differently. The vast majority of deals historically were focused on achieving scale. In those situations, 'value' was measurable from a short-term perspective in terms of synergies achieved and market share gains. But when making deals for strategic transformation purposes, 'value' is typically perceived from a longer-term perspective, and thus becomes much more difficult to define and measure.

The first step, therefore, is for financial services CEOs and their M&A and Corporate Development teams to clearly define future ambition and design executable strategies that align with and enable the organization's transformative goals.

Defining future ambition

Everything should link back to value. Understanding the 'true' potential value of an acquisition or partnership can give CEOs more confidence going into a deal and help ensure that their M&A and Corporate Development teams achieve the value that was expected at the outset.

More than simply working with the business leaders to define and understand their future ambition, the key to success is in using that information to reorient the way the dealmakers think about everything from deal origination and valuation through to structuring and integration. It's about making sure there is strategic alignment between the business leaders and the transformative deals being pursued.

The pitfalls of making deals without this critical first step are myriad and far too common. We have seen financial services firms snap up unique fintech companies only to squash their uniqueness with bureaucratic controls and force-fit cultures. Others have invested early into innovative technologies and then failed to appropriately integrate and scale the innovation across the enterprise.

> "...46 percent of financial services CEOs said they now see **inorganic growth strategies as the fastest way to transform their business and operating models,** according to KPMG International's CEO Outlook survey."

[1] Global CEO Outlook 2019, KPMG International

Chairman's message
Cover story
Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

The truth is that even the most tough-minded business leaders can 'fall in love' with a potential acquisition target and misjudge its present worth, potential value and long-term suitability as a strategic acquisition.

Those that get this first step right, however, are the ones that make sure the 'front end' of the dealmaking funnel is pointed in the right direction to achieve the organization's strategic transformation objectives. They are targeting investments they already know they can integrate into their business. And they are buying assets they are confident can scale and adapt as the organization grows.

Designing executable strategies

Sourcing the right strategic deal and partnership opportunity is one thing. The ability to strategically integrate them in a way that enables the organization to transform and deliver the value expected is another thing entirely. But here, too, CEOs and their M&A and Corporate Development teams have a critical role to play. More often than not, deals are signed and then 'tossed over the wall' for the business leaders and functional executives to deal with.

KPMG member firms' work with leading financial services institutions suggests that not enough time is spent working with business leaders and other internal stakeholders to plan ahead for the integration prior to signing the deal. Successful integration of deals that are done for strategic transformation purposes require strong leadership, robust governance and relentless orchestration across the enterprise — addressing critical people, process, systems and (perhaps most importantly) cultural issues.

Clarifying the degree of integration and level of effort required to maintain focus on value realization, problem resolution and value creation is typically underestimated. Addressing cultural issues in both the acquiring company and the acquired company will help accelerate the transformation of the organization towards 'acting as one'.

In our experience, post-deal business transformation and integration initiatives require well-informed decision-making processes with respect to the strategic choices to be made for the combined organization. Identifying integration options for the prioritized operating model choices (varying the degree of integration and the sequence of integration) is critical for maximizing and accelerating synergy capture and value creation.

Clearly, each deal and partnership opportunity will be different; understanding and responding to the nuances of each situation will be key. It is therefore important to have the ability to track — and the agility to 'course correct' — any deviation to the proposed value creation plan and attainment of the defined future ambition.

Ultimately, the point is that more work needs to be done at the front-end and at the back-end of the deal to ensure that the deal and/or partnership enables the desired transformation and value is achieved. If transformation is the ultimate goal, the days of simply 'doing deals' and 'tossing over the wall' are over.

Ready for what's coming

Financial services institutions are expecting their M&A and Corporate Development teams to help them deliver on their transformation objectives.

Those who are quick to adapt their dealmaking and partnership strategies to reflect the transformation objectives of the organization — from deal identification through to post-deal integration — will not only be better placed to achieve the transformative value they expect, they will also be better placed to pivot as the markets shift.

Those serious about delivering transformative outcomes, therefore, may want to start by talking to their dealmakers on how to enable organizational transformation. ■

> "... when making deals for strategic transformation purposes, **'value' is typically perceived from a longer-term perspective**, and thus becomes much more difficult to define and measure."

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

> Successful integration of **deals that are done for strategic purposes require strong leadership, robust governance and relentless orchestration across the enterprise** — addressing critical people, process, systems and (perhaps most importantly) cultural issues.

Contributors

Ram Menon
KPMG in the US
E: rammenon@kpmg.com
Ram leads the Insurance Deal Advisory practice KPMG in the US and KPMG International. He has led many domestic and cross-border mergers, acquisition and divestiture projects, providing deal and strategy-related advisory services.

Giuseppe Latorre
KPMG in Italy
E: glatorre@kpmg.it
Giuseppe heads the Global Financial Services Deal Advisory practice for KPMG International. He has extensive experience leading large scale M&A operational projects, including tender offer on listed entities, company valuations, bonds and equities issues for various Insurance companies, and in drafting strategic business plans for medium-term financial institutions.

Chairman’s message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Agility with discipline:

Transforming MUFG's Transaction Banking business

Ranjana Clark, Head of Global Transaction Banking, MUFG
Chris Hadorn, Head of Global Payments, KPMG International

Everyone talks about the need for transformation on the consumer side of the banking business, but what about the strategies that underpin global trade and finance: How is Transaction Banking changing to keep up with evolving customer needs and increasing competition?

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Ranjana Clark has no doubt that transaction banking is at the front end of a period of massive disruption. As a former executive at PayPal and Western Union, she has spent the past few decades orchestrating and managing market disruption in the payments space.

Today, she is Head of Global Transaction Banking and Head of Transaction Banking Americas at MUFG (one of the world's five largest banks by assets), and Ranjana recognizes that she is, once again, staring at the onset of managing a large platform that is ready for change.

Ripe for disruption

"Generally speaking, payments and transactions can represent pain points for clients, and that creates a lot of room for technology-led disruption," she noted. "Particularly in developing markets — but also here in the US — using money isn't easy. Moving money across borders is also particularly difficult. The whole area is ripe for disruption."

The size of the prize is also luring in a range of new players. From VC investors to fintech upstarts and tech giants (Facebook's new Libra currency being the most obvious), there is a massive amount of capital pouring into new payments and transaction technologies and companies. The field of competition is getting larger.

Customer-led

Like most banking executives, Ranjana recognizes that it is the client that is at the center of today's digital disruption. Customers — even Corporate Treasurers and CFOs — are starting to demand more efficient and accessible services. And that is influencing the transformation road map within Transaction Banking, globally.

"Whether you are talking to consumers or the Head of Treasury, everyone has the same basic needs," she noted. "They want to save time, save money and stay secure. For corporate clients, that may mean better straight-through processing of payments, or maybe it means more automated and cost-effective cross-border transfers. You really need to start with an understanding of your customers' needs."

Focused transformation

For Ranjana and her Transaction Banking Americas team at MUFG, the approach to transformation is centered on four main pillars.

The first is to create a front end that is intuitive and easy to use. As Ranjana notes, consumers now expect their banking services to be as easy to use as Amazon or Facebook. Those expectations are bleeding into the world of Corporate Payments.

The second pillar is around open data and open banking. "Right now, markets around the world are moving towards 'open' architecture models. We need to make sure that our transformation initiatives are moving us towards an open banking environment which, in turn, will open opportunities for us to serve clients in new and secure ways."

Similarly, Ranjana's team is continuously exploring how emerging technologies (such as machine learning, artificial intelligence, and natural language processing) might help the organization achieve its transformation goals faster, more efficiently and more effectively. "AI may be hugely overhyped in the market, but it is still the trend that has the longest legs and most value to deliver to the banking sector," she noted.

The final pillar — or maybe more precisely, foundation — is a flexible and agile core banking system. Like most banks, MUFG is actively working to modernize its core banking systems and infrastructure. Banks want to deliver efficiency and offer the most current capabilities, all while maintaining safety. "Our focus there is to move into the cloud while ensuring the highest levels of security," Ranjana said.

> "Right now, **markets around the world are moving towards 'open' architecture models**. We need to make sure that our transformation initiatives are moving us towards an open banking environment."

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Sharing ideas and technologies

Obviously, Transaction Banking is not transforming in a vacuum. All across the MUFG lines of business, transformation teams and business leaders are working together to move the group's strategy forward. Teams are focused on creating a consistent digital channel and a liquidity solution for clients who are looking to do business globally, across multiple platforms and in different currencies.

"We are running a large technology and digital transformation program within MUFG in the Americas, and a lot of the work we are doing there will influence and support the objectives we have within Transaction Banking. We are continuously looking for opportunities to leverage our experiences from other parts of the business," Ranjana noted.

In order to help encourage the rapid sharing of ideas, insights and best practices across the enterprise, the group has also created a network of digital champions. "The focus of that network is to encourage the rapid cross-fertilization of ideas so that they can be disseminated back into the regions without having to reconstruct all the skills, capabilities and development that have already happened."

Agility at the frontline

To ensure that the team is either delivering on new ideas or shelving them, Ranjana's team takes a much more agile approach to transformation. Starting with a specific customer pain point or need in mind, the team rapidly prototypes and iterates a range of solutions and ideas that are then moved back into the business to either shelve or scale.

"We've tried to take some of the core principles of technology investing, and then executed them with an agile approach in order to take them mainstream across our business. We recognize that some of the ideas won't work and that some won't warrant additional investment. But the point is to find that out quickly and make the right decisions. We need to make sure we are moving fast," she added.

An evolving journey

Ranjana recognizes that her group's transformation journey is just getting started. And no matter how fast her team moves, the market will continue to evolve and customer expectations will continue to change.

"We need to remember that money is, increasingly, becoming a digital asset. Where there are pain points and opportunity in the digital world, disruption is sure to follow," she noted. "Payments is a great use case for technology. It's no surprise it's at the center of today's digital banking transformation."

Hear from Ranjana on her views on the Future of Payments in 2030.

Contributors

Ranjana Clark
Ranjana is the Head of Global Transaction Banking, Head of Transaction Banking Americas, and Bay Area President. Before joining MUFG, Ranjana served as Chief Customer and Marketing Officer at PayPal, and as Global Head of Strategy and President of Global Business Payments at Western Union.

Chris Hadorn
KPMG in the US
E: chrishadorn@kpmg.com
Chris has over 20 years of financial services experience in the banking, regulatory and consulting industries. Leading KPMG's Global Payments team, Chris collaborates and partners with clients to support their payments transformation needs, including real-time payments and cross-border interoperability.

Chairman's message
Cover story
Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

The view from the CEO's office

Financial services CEOs know they need to do things differently to win in today's economy ...

72%

say growth relies on their ability to **challenge and disrupt** any business norm.

67%

believe that, without **agility**, they would be facing bankruptcy.

... And they are taking big steps to transform their enterprises.

45%

plan to **upskill** more than half of their entire **workforce**.

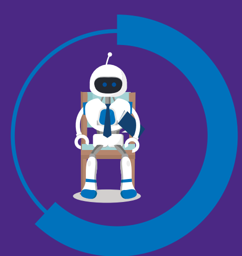
56%

say they have begun using AI.

But are they truly ready for a customer-centric, disruptive environment?

64%

admit they need to significantly improve their understanding of customers.



62%

say they need to improve their innovation processes and execution.

To be resilient, organizations need to be comfortable disrupting their business models. They need to be agile.

In this issue of *Frontiers in Finance*, we offer ideas and insights from leading financial organizations and KPMG subject matter experts on how to re-evaluate, re-imagine and re-define their business models and operating strategies for long-term sustainable growth. To learn more, contact your local KPMG office.

About the survey

KPMG International surveyed 345 financial services CEOs across **11 jurisdictions** in order to understand the challenges and opportunities they face and their vision for the business of tomorrow. The sample sizes were as follows:

Banking, n = 132
Insurance, n = 132
Asset management, n = 81

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Connect to compete:

Delivering the next-gen target operating model

Isabel Zisselsberger, KPMG China
Darren Pigg, KPMG China
Bill Packman, KPMG in the UK

You are investing considerable time and effort into transforming your organization. But are you confident that you are transforming towards the right target operating model?

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Across all geographies and sectors — asset management, insurance and banking — transformation programs and initiatives are underway. In fact, we aren't aware of a single firm that isn't currently in the midst of a 'transformation' program of some sort.

Yet, in our recent survey of financial services CEOs,[1] a full 70 percent feel the lead time to achieve significant progress on their transformation programs overwhelming. Moreover, working with executives around the world, few know what, exactly, they are transforming towards; their vision for the 'next-generation' target operating model is unclear. And that has left many organizations focusing on piecemeal modernization programs.

The future is connected

The future is very clear. Our view of the market suggests that it is dominated by 'connected enterprises' — organizations that are able to integrate a pure customer focus into their day-to-day operations; those where silos have been broken down to connect the entire customer journey from the front office to the back office; organizations that are deeply entwined into dynamic ecosystems and partnerships; those that forsake traditional models and roles to radically rethink the value they provide to their customers. These are the characteristics of the 'next-gen' financial services firm.

If you're not convinced, just look around at the changes already underway across the financial services industry. In Asset Management, lines are already being blurred between manufacturers, distributors and advisors. Insurers are using technology and customer data to move from protection to prevention which, in turn, is creating new models and inspiring new relationships. Most banks have now achieved a single view of their customers and are using their data to delight their customers with more than just competitive rates.

What these organizations are doing is putting the customer at the center of their next-gen operating model, taking the time to understand what their customers will want in the future and then redesigning their organizations around those needs and expectations. It isn't easy. And there will be significant challenges along the road.

Focus on the customer

The first big challenge is in understanding what the customer of the future will want. What role will financial services firms play in the life of the consumer? How will consumers interact with brands, humans and machines? What will they expect from the experience? What will they value from their banks, asset managers and insurers?

The next challenge is to translate that vision into a new target operating model. And the key here is to focus on simplification. Above almost everything else, customers are looking for simple, efficient and effective services. The more simplified the processes that support those services, the better.

Once again, that means connecting the enterprise: connecting processes from the front office through the middle and back office; connecting the customer vision with the operating model and business models; connecting the traditional business with new and innovative capabilities; and connecting with customers in ways that drive value for all stakeholders.

The road to the connected enterprise

At KPMG, our network of professionals has worked with many of the most (and some of the least) connected financial services firms in the world. Our experience has led us to identify eight fundamental capabilities that are key to creating a more connected financial services enterprise. These include things like product, pricing and customer strategy; technology architecture and enablement; and organizational alignment and people capabilities.

Improved capabilities around partnerships, alliances and vendors — in particular — will be key. Indeed, if a connected target operating model is the destination to be reached, then third-party collaboration is the vehicle and customer data is the fuel.

> “Above almost everything else, **customers are looking for simple, efficient and effective services**. The more simplified the processes that support those services, the better.”

[1] Global CEO Outlook 2019, KPMG International

Chairman's message
Cover story Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

In a connected next-gen operating model, financial services firms will need to rely on the technical and operational capabilities of countless other partners in the value chain — from cloud service providers and outsourced process specialists through to fintech/insurtech start-ups and even competitors. Balancing the need for control and oversight against the desire for simplification will be an ongoing challenge.

At the same time, the ability to leverage technology and data analytics to effectively and efficiently deliver cross-channel experiences, provide employees with enabling tools and act on forward-looking data-enabled insights will be key to achieving the next-gen target operating model for financial services. More often than not, that will require firms to adopt an enterprise-wide connected and controlled intelligent automation strategy that underpins the next-generation operating model across all functions.

Financial services executives will need to remember that, while partnerships may be the vehicle and data the fuel, it's still people that are driving the transformation. This means that financial services organizations will need to rethink their current capability sets, talent management approaches, incentive programs and skill development. Being able to proactively identify and fill talent gaps (either by hiring, developing or partnering) will be critical to ensuring the operating model remains agile, customer-centric and effective.

Get connected or get left behind

In today's financial services environment, organizations need to transform if they hope to survive. But first they need to have a clear understanding of what they are transforming towards and how they plan to get there.

Our experience and research suggest that the future will be dominated by the most connected and customer-centric enterprises. If that doesn't sound like your next-gen target operating model, you may want to stop and reconsider your transformation program.

The eight capabilities of KPMG Connected Enterprise

Insight-driven strategies and actions

Harness data, advanced analytics and actionable insights with a real-time understanding of the customer and the business, to shape integrated business decisions.

Innovative products and services

Develop compelling customer value propositions on price, products and services to engage the most attractive customers and drive profitable growth.

Experience-centricity by design

Design seamless, intentional experiences for customers, employees and partners, supporting the customer value propositions and delivering business objectives.

Seamless interactions and commerce

Interact and transact with customers and prospects across marketing, sales and service and achieve measurable results.

2x impact

Responsive operations and supply chain

Operate the business with efficiency and agility to fulfill the customer promise in a consistent and profitable way.

Aligned and empowered workforce

Build a customer-centric organization and culture that inspires people to deliver on the customer promise and drive up business performance.

Digitally enabled technology architecture

Create intelligent and agile services, technologies and platforms, enabling the customer agenda with solutions that are secure, scalable and cost-effective.

Integrated partner and alliance ecosystem

Engage, integrate and manage third parties to increase speed to market, reduce costs, mitigate risk and close capability gaps to deliver the customer promise.

Chairman's message
Cover story
Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

> In a connected next-gen operating model, **financial services firms will need to rely on the technical and operational capabilities** of countless other partners in the value chain.

Contributors

Isabel Zisselsberger
KPMG China
E: isabel.zisselsberger@kpmg.com

Isabel is the Head of Customer, Operations and Finance Consulting in Hong Kong (SAR) for KPMG. Isabel helps financial institutions transform their target operating model and implement intelligent automation strategies.

Darren Pigg
KPMG China

Darren leads the KPMG China, Insurance, Customer and Analytics practice. His experience lies in human-centered design, behavioral economics and customer data analytics for large scale transformation projects.

Bill Packman
KPMG in the UK
E: bill.packman@kpmg.co.uk

Bill leads KPMG in the UK's Wealth and Asset Management Consulting practice, focusing mainly on helping independently owned Wealth Managers and the Wealth divisions of established banks.

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Does banking's future outweigh its past?

Ian Pollari, KPMG Australia
Anton Ruddenklau, KPMG in the UK

On the surface, at least, it's a conundrum. How do banks face profound industry changes driven by rapidly evolving customer expectations, emerging technology and new digital challengers when millions of dollars are invested in inflexible, though robust, legacy systems that served them in the past but are not fit for future needs? Given the dominant market share of incumbent banks and the relatively small inroads made by digital challengers, how quickly do traditional banks need do move? Should changes be piecemeal, transformational or totally greenfield?

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

To companies in the banking industry, the story is a familiar one. Customers with connectivity at their fingertips are demanding cheaper, faster and better banking experiences. A plethora of challenger banks and new market entrants are emerging to meet these demands — armed with innovative technologies and unencumbered by the legacy infrastructure that restricts traditional financial institutions. Yet, traditional banks still have the lion's share of the business, enviably strong brands, large customer bases and high visibility.

In the face of this, many banks are investing heavily to drive innovation, enhance agility and become more customer-centric. For the majority, these investments comprise patchwork upgrades to legacy systems and incremental change. Organizations are reluctant, indeed, to walk completely from these systems owing to substantial investments in them, concerns for reliability, and the simple fact that these systems have been so central to past successes. Other financial institutions are taking different paths to reposition themselves.

One thing is clear: Traditional banks cannot afford to apply patchwork upgrades to their legacy systems. Nor can they assume that system upgrades, even bold and ambitious ones, will translate to a sustainable competitive advantage over the long-term. While the pace of technology change in financial services has been more gradual than in other industries, in part due to regulatory restrictions on new market entrants in many jurisdictions, the ability of companies to rapidly adapt will only become more critical over time. The degree of industry change is such that banks need to think more radically about what they want to become and how they want to get there if they expect to thrive.

What will the banking industry look like in 2030? Business models, just like the industry as a whole, will be transformed by technology. New models will emerge in the years ahead putting a halt to the band-aid approach to legacy systems. Banks will look to new architecture that is digital to the core, and more will choose to build and migrate to new systems.

Under pressure: Digital banks making inroads

Challenger banks — such as Starling Bank, Atom Bank and Tandem — have existed in the UK for a number of years. Fidor and N26 were the first of the European digital banks. The model is now emerging in other parts of the world. Indeed, there are approximately 100 challenger banks worldwide, including:

- SolarisBank and N26 in Germany
- MyBank, WeBank and Kakao in Asia
- Nubank in Brazil
- Chime in the US
- 86400, Volt and Xinja in Australia.

In March 2019, the Hong Kong Monetary Authority announced that banking licenses had been granted to no less than three digital banks in the territory. These entities are expected to go live later this year.[1]

Though still dwarfed by their traditional counterparts, digital banks are growing fast, leveraging their adaptability, customer-focus and ability to make data-driven decisions. While they might not, as yet, have customer bases to rival traditional players, they are starting to make inroads. Traditional financial institutions should not overlook the growth potential of new digital challengers who could, over time, win a share of market segments, in particular the growing cohort of millennials.

> “One thing is clear: **Traditional banks cannot afford to apply patchwork upgrades to their legacy systems.** Nor can they assume that system upgrades, even bold and ambitious ones, will translate to a sustainable competitive advantage over the long term.”

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

[1] https://www.hkma.gov.hk/eng/key-information/press-releases/2019/20190327-3.shtml

Approaches include:

> "A number of traditional banks have **purchased digital banks as a way to make rapid changes.**"

Responding to a new reality

Over the past 5 years, many financial institutions have invested millions in innovation programs focused on enhancing their technological capabilities, as well as trying to become more agile. The approaches they've taken to make these changes have varied based on their existing strengths, business strategy and identified gaps.

Legacy system updates

Numerous traditional banks, as noted, have invested heavily in updating their legacy technology in order to remain competitive. These investments include upgrading credit systems in order to approve loans more swiftly, making systems compatible with application programming interfaces (APIs) and open banking regimes, or finding ways to integrate more robust data analytics. While good, these incremental changes are unlikely to give traditional institutions the competitive edge they need to stave off new competitors.

Purchasing a digital bank

A number of traditional banks have purchased digital banks as a way to make rapid changes. Canada-based Scotiabank acquired digital bank ING Direct (Canada) back in 2012.[2] This trend has become much more pronounced in recent times. For example, Nordic bank, Nordea reported in March 2019 that it had acquired Gjensidige Bank[3] and the Royal Bank of Scotland (RBS) recently purchased a 25 percent equity stake in digital start-up Loot.[4] RBS made the investment through its digital bank, Bó, which is currently under development.

Purchasing an existing digital bank gives the incumbent the flexibility to change or retain the purchased brand name. They can also either migrate existing customers over or grow the offering's existing customer base organically and through cross-promotion. Banks that elect to migrate customers, however, run the risk of incurring significant expenses as a result of a need to write off aging legacy systems more quickly than they might have otherwise.

[2] https://www.cbc.ca/news/business/scotiabank-to-buy-ing-bank-of-canada-for-3-1b-1.1160516
[3] https://www.nordea.com/en/press-and-news/news-and-press-releases/press-releases/2019/03-01-09h52-nordea-completes-acquisition-of-gjensidige-bank.html
[4] https://www.finextra.com/newsarticle/33169/new-rbs-digital-bank-invests-in-loot

Chairman's message
Cover story
Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

Establishing a digital bank

A number of traditional banks have established their own digital banks. As mentioned above, RBS, in addition to investing in an existing digital bank (Loot), is developing retail bank Bó and just last year launched Mettle,[5] a digital bank targeting small and medium enterprises (SMEs). Other well-known examples range from Marcus (Goldman Sachs) in the US to Pepper (Leumi Bank) in Israel.

Establishing a digital bank provides legacy banks with similar flexibility in regards to branding and building a customer base. The time and investment required, however, to develop a new business model and build the brand can be exorbitant. Significant resources are needed to erect the five pillars of any digital bank: senior management, licensing, funding, technology, and customers. To deal with this, some banks are turning to digital banks for assistance. RBS, for example, have partnered with Starling Bank for help with their digital foray.[6]

Starting a bank can provide a successful defense against new challengers with improved services and open capabilities. The new, more competitive business model provides for lower costs, greater agility and greater modularity. New technology stacks put incumbents on a level playing field with upstarts and customers can be readily migrated over.

Digital banks are also often referred to as 'lifeboat' banks. Should the digital bank prove operationally resilient, traditional banks will consider migrating their legacy customer books to the new entity. This helps replace legacy infrastructure with new technology, and helps solve the agility and customer experience issues that banks struggle with.

The elephant in the room: Change isn't all about technology

If banks are to successfully face the challenges posed by new digital competitors and changing customer expectations, they need to think beyond technology. Whatever path of change a bank undertakes, whether organic or inorganic, it must be partnered with a willingness to entirely rethink their strategy and business processes in order for their transformation to be successful. This means objectively considering the use of mobile apps, the cloud, customer accessibility, the use of big data — and defining how any decisions will contribute to the organization's overarching business strategy.

To be successful long term, a major cultural shift is required, one in which employees at all levels come to appreciate and even value a company's transformation. While many financial institutions know they need to change, few recognize the magnitude of change required or the degree of internal resistance they might face to change. To manage this resistance, change management needs to be an up-front, ongoing and persistent component of any bank transformation initiative. Additionally, any associated communications program should be aimed at attracting converts, even evangelists, to the effort right from the get-go.

Defining a digital banking strategy starts with a clear business model

What are your key objectives/ambitions?
Identify objectives and determine path forward with the right strategy to get there.

- Reinvention through new company
- Attract segment/cohort
- Gather deposits/extend credit
- Extend virtual footprint

What markets and clients do you want to target?
What demographic(s)?
What type: e.g. direct-to-consumer, marketplace, banking as a service?

- Personas
- Channels
- Propositions and brands

What approach will you take?
Prioritize and act on best approaches based on your portfolio and ambitions.

- Build
- Invest/acquire
- Partner

Source: KPMG International 2019

[5] https://www.bankingtech.com/2018/11/rbs-tests-its-sme-digital-entity-mettle/
[6] https://www.finextra.com/newsarticle/32581/starling-to-help-rbs-develop-digital-bank

Chairman's message
Cover story
Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

Forging a path forward: Questions to ask

There is no one path to success for financial institutions that want to increase their competitiveness and better respond to the needs of their stakeholders or the dynamic changes expected to continue to reshape the financial services industry in the years ahead. Companies need to determine their path based on a strong understanding of where they are today and what they want to become in the future.

As a starting point, companies should consider a number of pivotal questions that can help them define what they need to do. These questions include:

- How will you create and monetize value in the future?
- What changes are required to bridge the gap between where you are today and where you want to be?
- What is the cost-benefit associated with making necessary upgrades?
- Will modifications to legacy systems be sufficient to give you the flexibility to compete in the future?
- If not, how might brand new technology stacks be built at the bank?
- What are your time constraints and how long will different options take?
- What systems, structures or partners can you leverage as part of your transformation?

Acting today to thrive tomorrow

Banks that recognize the profound shift required and act now to transform their organizations to keep pace will emerge more competitive and successful than ever. It is our belief that although patchwork upgrades may seem like enough to stem the tide in the short term, companies willing to make more radical changes will be better positioned to lead the financial services industry in the years ahead. Those that adopt new business models and build and migrate to new technology stacks will be best prepared for digital competitors. ■

Contributors

Ian Pollari
KPMG Australia
E: ipollari@kpmg.com.au
Ian leads Banking for KPMG Australia and is Global Fintech Co-lead. He has over 16 years' experience in financial services and works with local and international banks, payment providers and fintechs in strategy development, market entry and digital innovation.

Anton Ruddenklau
KPMG in the UK
E: anton.ruddenklau@kpmg.co.uk
Anton is Head of Digital and Innovation for Financial Services at KPMG in the UK and Global Co-lead for KPMG Fintech. He specializes in business, corporate and institutional banking, and has extensive experience working with large global companies in consumer and technology.

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Spotlight

Goldman Sachs breaking new ground with Marcus

Harit Talwar, Head of Global Consumer Business, Goldman Sachs

Marcus by Goldman Sachs ('Marcus') bills itself as a 150-year-old start-up. The paradox aptly captures key reasons for the digital business' success — the brand, balance sheet and risk management DNA of a well-established financial institution with the agility of a start-up unhampered by legacy infrastructure, business practices and technology.

That combination, leaders believe, gives Marcus a distinct structural advantage, and the evidence suggests they're right. In just 3 years, the business has grown to approximately US$55 billion in deposits and US$5 billion in loans.[1] Marcus is projected to cross US$1 billion in revenue in 2020. Further, the business — Goldman Sachs' first-ever foray into consumer banking — believes it has an opportunity to disrupt the sector in the same way Amazon did to retail and Apple did to music.

There is more to Marcus' success, however, than a melding of the old and new. Based on rigorous financial modeling and analysis, Goldman Sachs has invested over US$1 billion in Marcus' development, knowing that it would be a long-term investment play with significant potential for growth.[1]

Moreover, Harit Talwar explains, the business maintains a laser focus on customer-centricity and has from the beginning. Since its origination, Marcus has spoken to over 100,000 consumers to understand their pain points and concerns around personal banking and finance. Ask any team involved with Marcus what they do and they'll answer with a customer focus in mind: enabling customer onboarding, improving the customer servicing experience or helping with the customer password journey.

It's not just talk. Engineering, design, data analytics and a culture of cross-functional collaboration are important, but how they enable the customer journey is what matters. The future of consumer banking, Harit believes, is in truly making life easier for customers. That means delivering on a promise of value, ease, transparency in customer interactions — and then making that promise repeatable. These efforts appear to be paying off. Last March, J.D. Power released its 2019 Personal Loan Satisfaction Study and Marcus by Goldman Sachs was named number one in personal loan customer satisfaction.[2]

Linked directly with this focus on the customer experience is Marcus, dedication to clarity of purpose – who the customer is, what their concerns are, and a determination not just to say but to prove that customer problems and concerns matter. Marcus has authentically embraced customer-centricity, and not simply using it as branding spin, because it translates to competitive advantage and shareholder value. "Innovation works when you use technology to actually help customers," Harit says. "The real secret sauce in fintech is when you use your technology, data and balance sheet capabilities to help customers empower themselves and meet their own needs. That is what innovation is all about."[3]

Marcus, with its singular focus on customers, is proving a game-changer. Armed with technology, a strong balance sheet and a clear vision, this young digital start-up is swiftly becoming a powerhouse. In an era of disruption, Marcus by Goldman Sachs is paving a road of possibility for traditional banks. ■

Contributor

Harit Talwar
Head of Global Consumer Business, Goldman Sachs
Harit joined Goldman Sachs in 2015 as a Partner and is currently the Head of Global Consumer Business. He is also a member of the firmwide Client and Business Standards Committee and the America's Diversity Committee.

[1] As of the firm's Q3 2019 quarterly earnings call
[2] Marcus by Goldman Sachs received the highest score in the J.D. Power 2019 U.S. Personal Loan Satisfaction Study of customers' satisfaction with the personal loan experience. Visit jdpower.com/awards
[3] Quotation extracted and lightly adapted from video interview with Harit on YouTube

Chairman's message
Cover story Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

Flexibility for growth:

Operational excellence in an era of digital disruption

Michael Adler, KPMG in the US
Scott Shapiro, KPMG in the US

In today's rapidly changing and increasingly competitive market, insurers are looking for every opportunity to improve their operational efficiency. Yet most insurance executives admit they are already falling far behind on their targets. What will it take to achieve operational excellence in today's insurance industry?

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Ask any insurance executive about their operational efficiency efforts and you are sure to hear a long list of plans and ideas. In fact, according to a survey of insurance executives conducted by KPMG International and ACORD,[1] a global insurance industry standards-setting body, 94 percent of insurance executives say they are currently working on initiatives to improve operational efficiency.

Missing the mark

The problem is that more than half — 54 percent — of those executives are also quick to admit that they have started to fall behind their targets.

In our KPMG International report on operational excellence in the Insurance sector, we found that the risk to the enterprise of delaying action is increasing and ultimately a threat to the company's relevance in the competitive marketplace.

Conversations with insurance executives suggest that many are worried that their lack of progress is already hurting their business; they feel their costs are becoming less competitive, their operational agility is lagging customer expectations and their ability to grow is being constrained.

The respondents were also rather clear about why they were falling behind. Many complained about a lack of clarity on their key objectives and an inability to agree on strategic decisions at the enterprise level.

Some noted a scarcity of qualified resources, particularly those that combine new technologies with insurance fundamentals. Most raised some sort of concern about the state of their legacy infrastructure and processes.

Integrate to accelerate

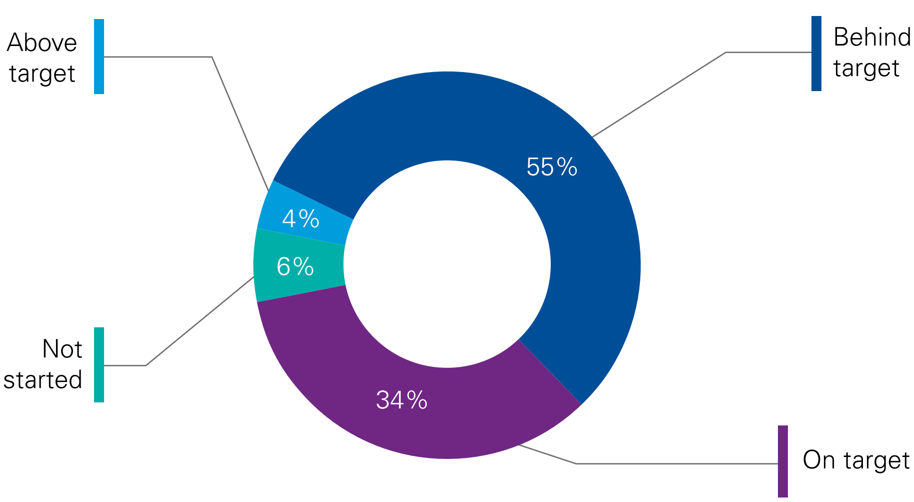
The greatest barrier to insurers achieving their operational efficiency goals comes down to a lack of integration.

In fact, our survey shows that — even after years of investments into new platforms and infrastructure — most insurers have managed to achieve only a 'limited' level of integration between their technology platform functions such as underwriting, distribution and product operations — key focus areas for operational efficiency efforts.

Interestingly, HR and Finance tended to report the lowest levels of integration. Even areas where one would expect to see existing high levels of integration — such as claims and policy servicing — were often ranked as being poorly integrated by insurance executives.

> "Any technology solution that can **deliver a better customer experience at a lower cost** (with the appropriate quality and controls) will be key in delivering longer-term operational efficiency."

Where are you in your operational efficiency journey?



Source: Operational Excellence in Insurance, KPMG International and ACORD, 2019

[1] Operational Excellence in Insurance, KPMG International and ACORD

Chairman's message
Cover story Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

The lack of integration across an insurer can result in incremental and redundant processes, technology and data — increasing costs and impacting an insurer's ability to serve customers and engage with agents.

Plucking lower hanging fruit

Unhappy with the current level and pace of progress, many insurance leaders are starting to shift the approach of their operational efficiency programs to prioritize faster wins and more tactical automation.

Indeed, our survey suggests that insurance leaders plan to reduce the amount of focus they place on the more foundational components — things like process standardization and legacy system fixes — to instead prioritize investments into Intelligent Automation (IA) and alternative sourcing.

In many ways, this is good news. Any technology solution that can deliver a better customer experience at a lower cost (with the appropriate quality and controls) will be key in delivering longer-term operational efficiency.

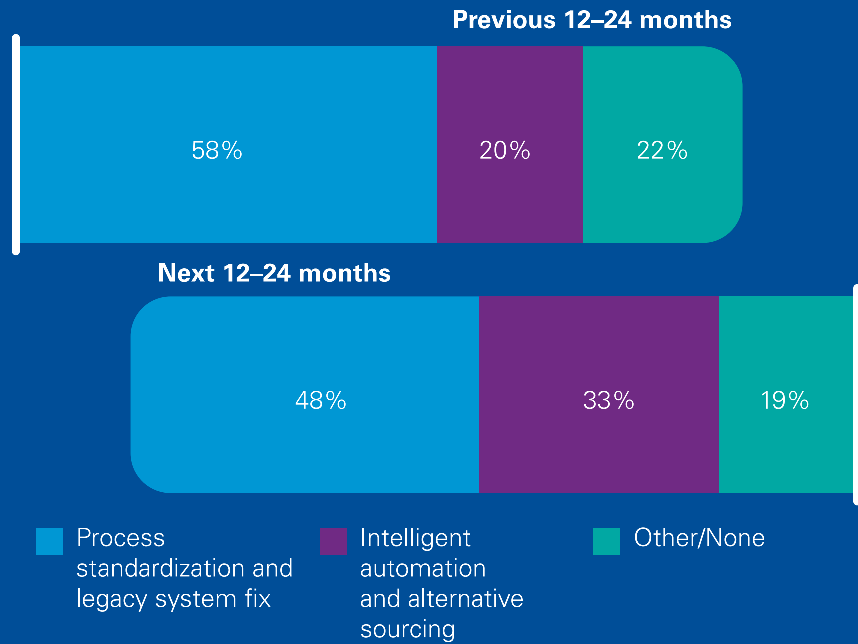
But they must be supported by ongoing efforts to standardize processes and modernize legacy systems. Yes, it's harder, takes longer and is less exciting to fix legacy systems. But that's the only way to convert quick wins into enterprise-wide operational value.

A framework for success

Our view is that insurers need to approach their operational efficiency efforts with an emphasis on maximizing value rather than minimizing costs; operational efficiency programs should focus primarily on the creation of a leaner, more flexible organization with cost reduction seen as the consequence of action rather than the goal of the action.

Our member firms' collective experience working with leading insurers across virtually every sector, geography and size has enabled us to develop a robust framework that can help insurers get their operational efficiency efforts back on track.

How did your organization pursue operational efficiencies in the past 12 to 24 months, and how does it plan to pursue them in the next 12 to 24 months? (Percent respondents)



Source: Operational Excellence in Insurance, KPMG International and ACORD, 2019

The framework focuses attention onto six key levers of operational excellence:

1. **Data:** the ability to find, capture and process massive volumes of external and internal data.
2. **Automation:** knowing where and how automation will help reduce friction, improve control and drive efficiency.
3. **Talent:** access to a future-ready workforce that is flexible and fully equipped to evolve into different roles.
4. **Infrastructure:** the presence of agile technology infrastructure that contributes to a scalable and flexible operating model.
5. **Analytics:** applying advanced analytics and machine learning to disparate data sets to uncover new insights that inform decision-making.
6. **Process:** eliminating inefficiencies by streamlining, standardizing, automating and eliminating tasks.

Chairman's message
Cover story Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

More decisions ahead

Achieving competitive levels of operational efficiency isn't easy. Years of product and geographic expansion, M&A, regulatory mandates and other factors have created layers of operational systems — many of which are either homegrown or heavily customized. Integrating these core systems into other, newer platforms remains a challenge.

Many insurers also seem to be struggling to know where to start. Not surprising: Today's insurers face a wide range of strategies and options for improving operational efficiency — from traditional cost take-out initiatives to emerging technology-based solutions like automation, cloud computing and sourcing. Prioritizing these options and aligning them against your long-term road map and current capabilities can be difficult.

Start with the road map

That is why we often help insurance clients take a more structured approach to delivering on their operational excellence journey — one that not only gets them to the optimal state, but then pushes further to encourage improvements to be self-sustaining.

It starts with articulating a vision for the organization that balances costs against customer expectations, digital requirements and efficiency. Through discovery and ideation, organizations are then able to identify important business patterns and co-create valuable solutions and growth opportunities. From there, we quickly move through to prototyping and prioritization. Then it's all about scaling up, sustaining and evolving the best and most valuable ideas.

Insurers may be falling behind on their operational efficiency targets. But today's technologies — things like big data, AI and machine learning — offer insurers a massive opportunity to not just drive out costs, but also achieve competitive advantage by delivering richer customer, agent and employee experiences.

Those insurers that have not yet achieved the benefits they are seeking from their operational efficiency journey may want to review their road map to ensure they are taking a long-term and strategic view that leverages all potential enablers that can help them reach their goals.

Achieving operational excellence in an era of digital disruption isn't easy. But it can be massively rewarding — for insurers, their employees, their customers and their shareholders.

For a more detailed analysis of our findings, visit kpmg.com/insurance and download our report — *Operational excellence in Insurance.*

Contributors

Michael Adler
KPMG in the US
E: michaeladler@kpmg.com
A Principal with KPMG in the US, Michael works closely with leading insurance companies to drive transformation, adopting digital, data, analytics, technology and best operational practices.

Scott Shapiro
KPMG in the US
E: sashapiro@kpmg.com
Scott is a Principal and the insurance leader for KPMG in the US' Risk Consulting practice specializing in operational improvement, data & analytics, and transformation.

Chairman's message
Cover story
Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

Next-generation banking technology and tax implications

Robin Walduck, KPMG in the UK
Richard Iferenta, KPMG in the UK
Burcin Nee, KPMG in the US

In our article, *The future of tax: The impact on new business models,*[1] we described how the business models in banking, insurance and asset management are changing, and set out some of the headline tax issues arising from this change. This article delves further into the detail of the models in banking and some of the challenges that organizations will need to deal with.

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

[1] Frontiers in Finance: Risk proofing the future, KPMG International, March 2019

The capital markets' IT landscape has changed dramatically in recent years due to a combination of next-generation technology and the transformation of IT operating models. Some of the models we see in banking include:

— **Next-generation IT operations:** Traditionally, technology ownership was in-house, with IT operations covering data centers, operating systems and vendor software solutions. This model has been reinvented, and the role of IT has fundamentally changed as a result.

— **As service providers:** The tier 1 banks are able to invest in technology at levels that cannot be matched by smaller players. They are now looking at how they can monetize this investment, offering services to the rest of the market.

— **Aggregated service model delivery:** New entrants often focus on just a slice of business operations, competing with traditional banks that offer an end-to-end business solution. Traditional banks are therefore looking at alliances to build scale and capability.

— **Full-scale digital retail banking:** Banks are exploring how they take digital retail banking to the next level, heavily focused on the customer, building highly customized models and driving demand for 'client-for-life' ecosystems to support with major life events.

These new models present a number of conundrums for tax departments as they grapple with how tax authorities will deal with the taxation of the changes in the way banks are operating.

A focus on corporate tax

As operating models change, tax departments in traditional banks may need to broaden their horizons to consider a number of different areas as follows:

— **Incentive regimes:** Many of these new models require organizations to innovate to stay relevant, be it in the design of a new digital banking platform or the integration of aggregated services into the existing infrastructure of the bank. This will potentially give rise to opportunities to make use of different countries' incentive regimes, such as research and development credits, or preferential rates for patented items or innovation-based activities.

— **Digital services taxes:** This is currently a contentious area, particularly with France and the UK having introduced digital services taxes (DSTs) in a targeted manner, and whether other countries will retaliate with reciprocal policy changes. While it is not expected that the current DSTs will have a material impact on these new businesses, as other countries introduce their own unilateral measures in relation to digital business models (for example, Spain, Austria and Italy are currently considering the possibility), the new measures need to be monitored, to ensure these models are not inadvertently caught by proposals that do not have effective carve-outs for financial services.

— **Location of taxable profits:** Digital business models in general are under significant scrutiny from tax authorities around the world, given the considerable complexity that these can bring on a cross-border basis, particularly when there may be no physical presence involved. Tax authorities are also starting to introduce anti-tax avoidance rules (such as the UK's Diverted Profits Tax) that focus on whether companies are artificially stripping profits out of a particular country, although it would be reasonable to expect that commercial operations of the nature set out above should not be caught by these rules.

“These **new models present a number of conundrums for tax departments** as they grapple with how tax authorities will deal with the taxation of the changes in the way banks are operating.”

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

A focus on transfer pricing

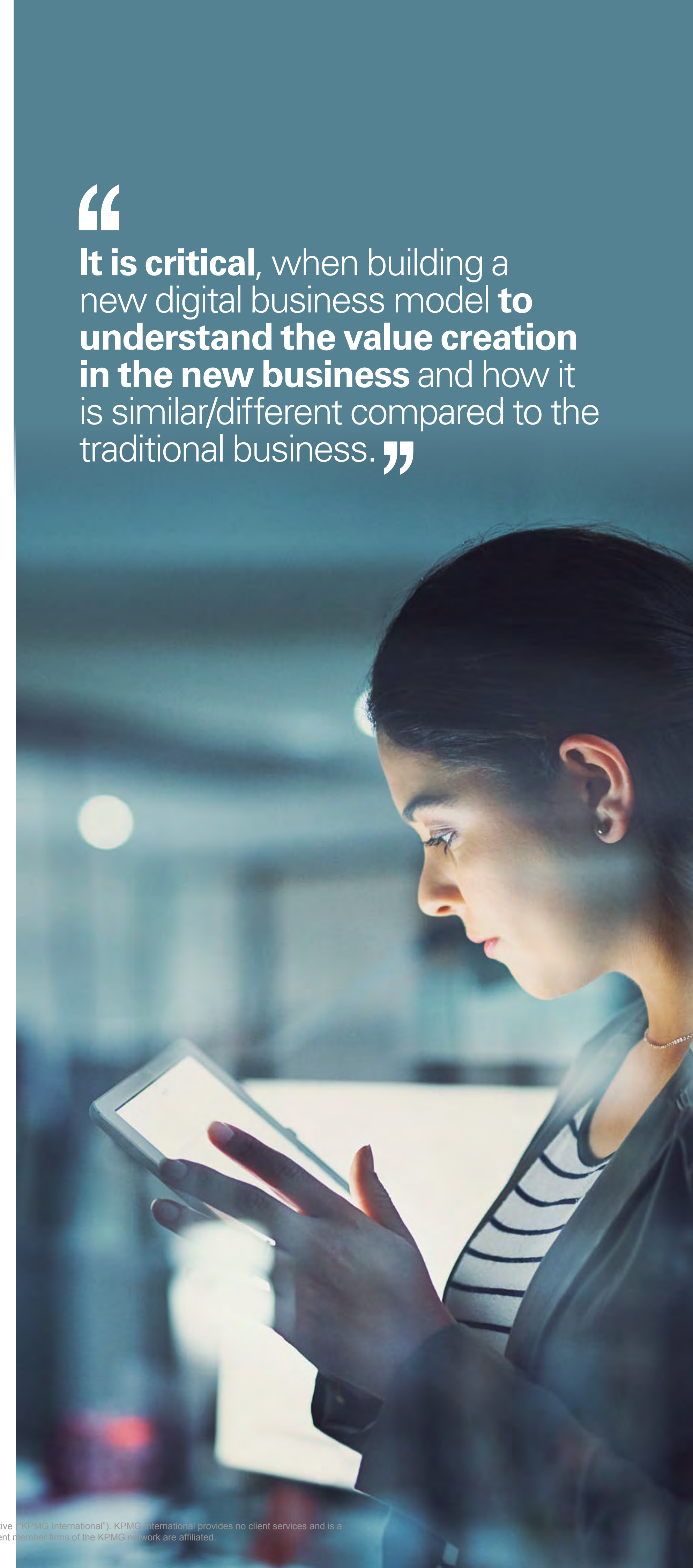
Any change in operating models will usually lead to consideration of the transfer pricing issues related to the change. Some of the key issues to be considered are as follows:

— **A possible new value chain:** It is critical, when building a new digital business model, to understand the value creation in the new business and how it is similar/different compared to the traditional business. For example, it will be key to understand the role of technology and brand intangibles, as well as data, synergies and network effects and whether they are market differentiators creating significant value. These concepts may be familiar territory for technology companies, but perhaps less so in financial services where the value chain typically centers around capital and people functions. Digital business models may therefore require a fresh look at value creation, the value chain, and associated transfer pricing for many financial services institutions.

— **BEPS:** The OECD's Base Erosion and Profit Shifting project has demanded a careful look and focus on DEMPE (development, enhancement, maintenance, protection and exploitation) functions, as well as the control of risk functions. This is particularly important where a new business model contains a high degree of use of non-routine valuable intellectual property.

— **Fintech driving revenue:** Where new financial technology is a key driver of revenue generation and increased profits, the transfer pricing policies used may need to be modified to incorporate a reward for the contribution of technology; such as when residual profit split or revenue/profit sharing approaches are employed. Depending on the fact pattern, one may also need to consider pricing based on royalties for the use of intellectual property.

> “**It is critical**, when building a new digital business model **to understand the value creation in the new business** and how it is similar/different compared to the traditional business.”



Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

A focus on indirect tax

Similar to transfer pricing, whenever operating models change, there needs to be a focus on indirect taxes, and the implications on cash flows in the business, particularly where these transcend borders. Some of the key issues that need to be considered with digital business models are as follows:

— **VAT liability of transactions:** Transformation of business models invariably results in new transactions being undertaken, such as outsourcing the IT build or indeed outsourcing the banking operations to bank utilities providing highly sophisticated banking platforms. The critical question from a VAT perspective will always be to determine the liability of such outsourced services. Clearly, there is benefit in such services being exempt given that banks (especially retail banks) have very low recovery VAT rates. The eligibility for exemption will be driven largely by the terms of the contracts and the economic reality. Structuring the contracts in such a way to maximize exemption is often well worthwhile.

— **Single vs. multiple supply:** There is the age-old issue of determining the extent to which a bundle of services being provided should be treated as part of a single supply or as separate supplies. This is critical in outsourcing contracts where there is scope for VAT exemption as poor structuring of contracts and the economic reality may result in services that should be treated as part of a single exempt supply becoming taxable. Typical examples of areas to focus on would be project management work, IT build, onboarding customers and variations to original contracts.

— **Engaging with the tax authorities:** Where the structuring is complex or the VAT consequences are unclear, it is often best to engage with the tax authorities up-front to avoid an unanticipated and perhaps costly VAT challenge at a later stage. The key to success in this regard is a good and clear explanation of the commercial model to the tax authorities and not only an explanation of what reliefs are available. It is, of course, equally important to anticipate the objections and counterarguments that may be raised by the tax authorities.

Reflections

These new business models are evolving and evolving fast. There will be new areas of technical knowledge that tax departments will need to engage on, and a thorough understanding of the business models that are being implemented is key to getting to the right answer from a tax perspective. The challenge of a tax department in any large financial services organization is to ensure they are sufficiently connected with the business to remain ahead of the developments, so that tax considerations can be factored in early as the business is set up. ■

Contributors

Robin Walduck
KPMG in the UK
E: robin.walduck@kpmg.co.uk
As the Global Head of Banking and Capital Markets Tax, Robin has over 20 years of experience advising some of the largest financial institutions globally. Robin has deep knowledge of international tax and treasury tax matters, together with considerable experience in executing cross-border financing and M&A transactions.

Richard Iferenta
KPMG in the UK
E: Richard.Iferenta@kpmg.co.uk
Richard heads up the Financial Services Indirect Tax practice with KPMG in the UK. A partner for more than 15 years, Richard specializes in, *inter alia*, structuring of transactions, cross-border transactions, disputes with the tax authorities and supporting financial institutions with implementing cutting-edge technology.

Burcin Nee
KPMG in the US
E: bnee@kpmg.com
Burcin leads KPMG's global transfer pricing practice and is a Principal with KPMG in the US. She is an economist by training. Since joining KPMG in 2000, Burcin assists her clients with transfer pricing documentation, restructuring, controversy, and advance pricing agreements (APAs).

Chairman's message
Cover story
Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

Evolving tax departments in financial services

At a glance insights for Financial Services tax leaders

Structure

Central tax departments most often fall within the:

54% Finance function

Most Chief Tax Officers (CTOs) or Tax Leaders report to:

46% Chief Financial Officer (CFO)

19% Head of Finance (other than CFO)

Only 37% of tax departments in FS use a shared service center (SSC), of which 80% have increased utilization.

70% Accountancy/ general ledger

50% Subledgers

50% Tax return preparation

40% Indirect taxes

35% Fiscal declaration processes

Over half of tax departments in FS are responsible for global reporting, while a high proportion are responsible for domestic reporting, compared to global cross industry averages (i.e. 61% global reporting and 74% domestic reporting):

57% Global reporting

87% Domestic reporting

Responsible tax

Most tax departments have a code of conduct to frame their risk tolerance and tax decisions.

76% Have a documented tax code of conduct

24% Don't have a documented tax code of conduct

Public disclosures of tax information:

48% No, don't disclose

33% Yes, we do this already

20% Somewhat, we disclose some limited tax info as part of our CSR

50% of the companies who don't currently disclose, plan to do so in the future.

Wish list

Tax technology and additional personnel topped the list for tax leaders when asked where they would invest if they had an additional budget.

53% Tax technology

19% Additional personnel

15% Process optimization

8% Training and education

4% Outsourcing

Tax leaders ranked the following process improvement priorities as important or very important over the next 5 years:

83% Process standardization

74% Consulting with business of operarting unit

72% Tightly connecting provision and compliance process

72% Formalizing risk management

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Technology

74% of respondents plan to increase their use of enterprise, finance IT systems for tax purposes

66% of respondents plan to increase their investment in tax specific technologies

31% of respondents are planning to invest in compliance software

40% of respondents are planning to invest in use of off-the-shelf provision systems

Department performance

Performance is often measured by the impact the tax department has on the business across a range of metrics, with these 5 most often topping the list of importance:

- 87% Tax risks are managed appropriately (versus 87% cross-industries)
- 87% Business units are satisfied with tax services provided (versus 68% cross-industries)
- 85% Accuracy of returns and avoidance of penalties (versus 75% cross-industries)
- 83% Tax compliance deadlines are met on schedule (versus 76% cross-industries)
- 82% Tax risks are consistent with corporate risk profile (versus 74% cross-industries)

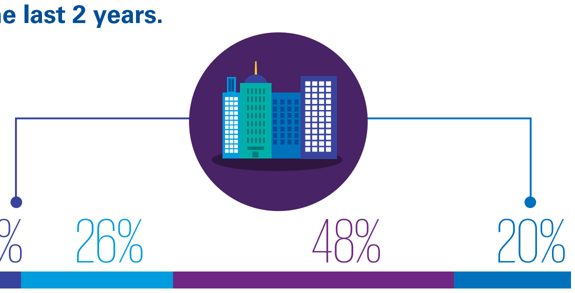
Business Impact

Most tax departments have oversight from a board member (or board-level individual) as tax continues to rise in importance on the board agenda.

75%
Yes, board member has tax oversight

25%
No, board member doesn't have oversight of tax

Today, tax departments are often consulted on the overall business strategy for the organization. 61% of respondents have seen an increase in involvement in the last 2 years.



7% 26% 48% 20%

- Not very/not at all involved
- Somewhat involved
- Well involved
- Completely involved

Most companies have a tax strategy or overarching tax governance policy document that covers tax risks.

76% of respondents have a documented tax strategy

60% review it annually

31% review it on an ad hoc basis

Assessing today and preparing for the future

KPMG International conducts an ongoing survey of tax leaders around the world, which considers ranges of responsibilities, department composition, budget structures and other data points to help tax leaders assess their departments today, and consider how to evolve them for the future.

The KPMG Global Tax Department Benchmarking Survey is an ongoing initiative that is establishing a meaningful benchmark of data for tax leaders around the world. To respond to the survey, please email tax@kpmg.com

Chairman's message
Cover story Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

AI offers the smartest solution for transition to RFRs

James Lewis, KPMG in the UK
Christopher Dias, KPMG in the US
Traci Gusher, KPMG in the US

Financial services organizations, industry working groups and regulators around the globe are working against the clock to successfully replace long-established London Interbank Offered Rates (LIBORs) with alternative risk-free rates (RFRs).

Chairman's message
Cover story
Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

LIBOR's decommission will significantly affect — and pose risks to — a diverse array of business functions being conducted by today's global financial institutions. More than US$370 trillion worth of contracts are said to be tied to LIBOR and other soon-to-be extinct benchmarks such as EURIBOR and TIBOR. RFRs have been designed to overcome the pitfalls of these rates — from minimizing reliance on expert judgment and ensuring a better reflection of the risk-free rate to avoiding past rate-related scandals.

LIBORs currently support a vast range of financial products and valuations across multiple jurisdictions — from loans, mortgages and leases to securitizations, derivatives and more. Global regulators have made it clear the current construct underpinning LIBOR is unsustainable and a threat to global financial stability. The Financial Conduct Authority has gone so far as to no longer compel banks to submit estimates for LIBOR. This shift in attitude towards the prodigious rate has effectively created a deadline of the end of 2021 to implement an alternative. Finance sector players are finding it challenging to navigate an uncertain environment and the transition's potential impact on their products, infrastructure, services, customers — and reputation.

Larger firms, in particular, face the overwhelming challenge of scrutinizing hundreds of thousands — if not millions — of contracts to identify LIBOR-based references, and problematic legal language, and develop a solution on time. And beyond how well banks make the transition, how effectively they communicate those changes to the market is deemed critical. Ultimately, we believe financial organizations should be looking at this challenge through four lenses: strategy, legal requirements, operational readiness and client communication.

Letting AI do the 'heavy lifting'

Given the sheer enormity of the problem, automation is being seen as the obvious practical solution, promising huge time and cost savings thanks to a level of speed and accuracy that manual processes simply cannot hope to match. Ultimately, the LIBOR transition opens the door to a fundamental rethink on the use of data and machine-learning techniques to better provide products and services to customers. We are advising clients to view the current LIBOR challenge as a 'once-in-a-lifetime' opportunity — a catalyst to making major advances towards innovative digital solutions that will transform their front-to-back infrastructure and processes.

While many firms are taking a 'wait-and-see' approach pending greater transparency from regulators, the good news is that a growing number of smart sector players have begun moving strategically toward artificial intelligence (AI) solutions as the clock ticks down to the transition deadline.

These organizations are structuring LIBOR transition plans that encompass enterprise-wide governance, contract identification, strategic planning, and the inventory of systems, infrastructure and functions that require change. We believe that the use of cognitive technologies — including natural language processing, machine learning and other AI capabilities — will be critical to success.

By automating repetitive, rule-driven processes combined with AI-enabled contract management and workflow, financial firms can quickly unlock an accurate and reliable solution to the transition challenge. Audit trails associated with this process, meanwhile, will provide the starting point to help any organizations facing future claims of misconduct and manipulation.

Beyond making the leap to RFRs successfully, businesses turning to AI will simultaneously position themselves to unlock abilities to streamline documentation making it more consistent, allowing for quicker changes (amendments) and ensuring that documentation and information systems are truly aligned. This will present opportunities to be competitive, significantly reduce costs, enable higher accuracy, faster deployment, improved compliance and risk management. The LIBOR transition presents the opportunity to deliver new functionality transforming a largely manual and error-prone process. In addition, AI opens up opportunities to better process and analyze data, which in turn can translate into competitive advantages.

The smart solution to an urgent challenge

At KPMG we've brought together two market-leading assets to automate contract analysis and remediation — solving the immediate LIBOR challenge while also creating opportunities for significant future

> “**... automation** is being seen as the obvious practical solution, promising **huge time** and **cost savings** thanks to a level of **speed** and **accuracy** that manual processes simply cannot hope to match.”

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

business benefits through transformational digital technology.

— Ignite, KPMG's global AI platform, enables KPMG professionals' to help businesses rapidly process and interpret massive volumes of contracts and unstructured data using machine learning and natural language processing. AI dramatically expands the spectrum of human cognition and capabilities. Businesses can then realize the promise of AI to solve the LIBOR challenge — providing insights on what tools to innovate with while offering outcome-driven approaches on how to strategically implement sustainable processes built on AI insights. Ignite is designed to work as an ecosystem that combines best-in-class components, people and technologies.

— Appian is a low-code, application-development platform that accelerates the creation of high-impact business applications. It is a fast path from idea to application, enabling document sharing, customizable business rules, real-time reporting and powerful process management. Low-coding is making it easier for companies to develop apps that work across a wide range of devices.

KPMG's proprietary Ignite platform is already being used by some organizations to reliably and rapidly extract information and answer specific queries relevant to LIBOR-based contracts, thereby revealing the correct path for a successful RFR-transition journey. The Ignite solution also generates, for customer review and approval, an amended contract based on the AI-based transition path chosen.

Automation as a solution to the LIBOR challenge, as noted, promises ongoing business benefits and advantages that go beyond identifying contracts and needed changes. Going forward, digital capabilities unlocked by a smart LIBOR solution will enable financial institutions to access applicability of AI in key areas such as risk management, compliance, operational resilience and more. Being more data-enabled, for example, will create additional capabilities that could prompt the creation of new products or services for finance sector clients.

Smart, forward-looking banks are already recognizing this broader reality and avoiding the temptation to let their LIBOR transition unfold in isolation. Some are realizing, for example, the connection between the LIBOR challenge and the Fundamental Review of the Trading Book (FRTB) — essentially a new market-risk rulebook developed by the Basel Committee on Banking Supervision to be applied to banks' wholesale trading activities. Banks are looking hard at the crossroads they now face and whether the time is right to do something fundamentally different in this area and far beyond.

Time is running out

Experience tells us that we are not seeing what we would consider an appropriate sense of urgency in the global financial services sector despite the formidable task ahead and its tight timeline. UK financial regulators recently noted their surprise over the "very different states of readiness for dealing with the transition and associated risks demonstrated by plans submitted." They also urged against firms taking a "wait-and-see" approach.

But sector players are not entirely to blame for being slow off the mark on this complex journey. As noted, they unfortunately also face a troubling reality amid the number of dependencies associated with the transition, the need of clarifying guidance from standard setters and the potential intervention from both regulators and legislative bodies to pave over some seemingly insurmountable hurdles.

Until banks and financial businesses know more regarding the fundamental 'building blocks' that will be instrumental to their success, we may see a continued reluctance to accelerate investment in solutions. But firms cannot simply sit idle pending more action from industry bodies and other key players. There is no time to lose and tapping into AI will give organizations the fastest and most reliable solution to today's — and tomorrow's — business challenges. ■

> "Automation as a solution to the **LIBOR challenge**, as noted, promises **ongoing business benefits** and **advantages** that go beyond identifying contracts and needed changes."

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Case study

Banking giants turn to AI

Several leading organizations in the global financial services sector are discovering — with KPMG professionals' insights and guidance — the immense impact that a strategic, AI-enabled transition to LIBOR can have on their efficiency and competitive edge. Tasks that would typically take up untold hours — if not days — of human productivity are being reduced to seconds thanks to AI's remarkable capabilities.

One major global bank recently turned to a KPMG member firm and our Ignite AI platform to assess more than 25,000 contracts representing billions of dollars in exposure — a formidable task that would have required an estimated 15,000 hours of manual work equivalent to four paralegals or lawyers working full time for about 22 months.

Much of the key information was typically buried across a huge array of PDFs and simple text documents that would have been almost humanly impossible to track down manually in advance of the 2021 RFR-transition deadline. We were able to successfully identify and extract all relevant contract details in a fraction of the time for a fraction of the cost, creating a comprehensive new database that will enable the banking giant's LIBOR transition. Automation typically completed within seconds a huge array of contract identification and analysis tasks that each would have taken humans hours upon hours to complete. Beyond the remarkable time savings, the automated LIBOR solution boasted an accuracy rate of up to 98 percent — versus about 85 percent for manual processes.

We recently completed another successful transition for a global banking giant that needed to identify, analyze and convert to machine-readable format thousands of loan contracts — each up to several hundred pages long. The bank had previously done similar proof-of-concept work with about 20 other consulting firms, technology vendors and AI boutique shops and was pleased to note that Ignite proved to be the only comprehensive solution that fully met its needs.

As many financial firms are discovering, the transition is too complicated to be tackled merely with software tools, given the complexity of working with unstructured data and converting countless complicated text documents to a machine-readable format. We've kept Ignite in a much more open format that we believe make it unique in the market — letting us achieve very high results across a range of use cases. Beyond LIBOR, our approach seeks to provide crucial new capabilities and advantages for future success thanks to the digital transformation being implemented as we convert key text documents to machine-readable forms. ■

To learn more about KPMG's AI-enabled contract management and workflow platform, watch our short video.

Contributors

James Lewis
KPMG in the UK
E: james.lewis@kpmg.co.uk
James is a Director of Risk in KPMG in the UK and leads KPMG's EMEA Regulatory Insight Centre. James has led a number of global IBOR benchmark engagements as the industry has been developing towards the new Risk Free Rates.

Christopher Dias
KPMG in the US
E: cjdias@kpmg.com
Christopher has over 30 years of international experience in financial markets as a risk practitioner and strategic advisor. He has helped several financial institutions successfully prepare and adapt to changing regulations and market challenges and has represented client interests to global regulators, communicated strategy to senior management, and presented complex issues to company boards.

Traci Gusher
KPMG in the US
E: tgusher@kpmg.com
A leader in KPMG's Center of Excellence for Data & Analytics, Traci is responsible for the D&A Strategic Transformation and Lighthouse Artificial Intelligence teams. She is an experienced executive with 17 years' experience in systems implementation, advanced analytics, big data technologies, AI and D&A strategy.

Chairman's message
Cover story Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

Tax, transfer pricing and transformation:

What Asset Managers may be forgetting

Anthony Brown, KPMG in Canada
Sherif Assef, KPMG in the US
Dr. Manuel Imhof, KPMG in Germany

Asset managers are making good progress transforming their organizations. But few seem to have thought about the tax and transfer pricing implications of their actions. Opportunities (and risks) could be missed.

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

You are a decision-maker at a respected Asset Management firm. You have recognized that the market is evolving — you have watched the rise of passive and alternative investment strategies, dealt with a range of new regulatory developments, managed growing cost pressures, and are adapting to the significant competition from Fintechs and online distribution channels.

If you are like most Asset Managers, you probably have a plan. And you are probably making good progress towards reinventing your operating models and processes to prepare your organization for the future. But have you thought about the tax implications of your transformation plan? Should you?

The rules are changing

Many of the changes that Asset Managers are currently making to their business and operating models will have a direct impact on their tax and transfer pricing positions. On the heels of the OECD's Base Erosion and Profit Shifting (BEPS) work, we have seen unprecedented changes to transfer pricing rules around the world. It's not just the scope of the changes that is creating challenges, it's also the pace. For example, ongoing reconsideration of transfer pricing models by the OECD may mean that changes to operating models will create reportable income in unexpected jurisdictions.

It's not just Asset Managers; national tax authorities are looking to transform their models as well, and they are moving quickly to implement their agendas. This includes a growing range of unilateral measures being adopted in certain jurisdictions. The passage of the US tax reform bill, for example, forced many asset managers to quickly rethink things like the volume and nature of intercompany payments, the location of value-creating functions and assets, the direction of related-party interest flows, and a range of other factors.

Role of technology

Many Asset Managers are changing the very fundamentals of their operating and business models in an effort to improve efficiency, enhance agility and increase transparency. New technologies and tools are being implemented to enable that shift.

Whereas, in the past, technology played a supporting role in the asset management model, today it is starting to assume a much more central position, often actively effecting investment decisions and executing trades. And that requires Asset Managers to rethink the role that technology plays in their value chain.

Asset managers with new robo-advisory or Artificial Intelligence (AI) tools, for example, may need to offer management fees significantly lower than those charged on traditional products. What will that mean for profitability? How will value be allocated to the technology asset versus the 'people' functions performed? How will a reduced management fee structure complicate existing revenue splits across the value chain?

Taking another look

Some of the more tax-savvy Asset Managers have started to recognize that their transfer pricing policies may be out of date. As a result, they are undertaking a number of aligned strategies to make sure they are not missing any opportunities or creating any new risks.

What are they doing? KPMG member firms' experience points to five main areas of activity.

1. **They are aligning their tax and transfer pricing function with the business.** The leaders are ensuring that tax and transfer pricing has a seat at the table when new products are being introduced. And they are encouraging their tax and transfer pricing professionals to speak up when they see risks or opportunities related to either new products or the wider operational transformation that is underway.

2. **They are assessing their value drivers.** Asset managers need to have a clear understanding of the value drivers that underpin their new operating models. That will allow them to properly assess how changes in, say, the sales function might impact online distribution, or how the use of AI might influence the way fees are distributed.

> "It's not just asset managers; **national tax authorities are looking to transform their models** as well, and they are moving quickly to implement their agendas."

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

3 **They are taking a closer look at the regulatory and tax changes.** Given the range of changes now underway across jurisdictions, Asset Managers will need to spend some time prioritizing them. Which will have the greatest impact? Can the impact be modeled with related scenario analysis? What options are available for mitigation? What is the timeline for change? And what will it cost? Answering these questions up front will allow for faster decision-making and more focused investment.

4 **They are augmenting their skill sets and capabilities.** Most Asset Managers run a fairly lean tax and transfer pricing function. And so they recognize they might lack the skills, experience and insight needed to anticipate and respond to recent changes in tax and transfer pricing rules. The leaders are fostering closer relationships with advisors that can keep them informed and moving in the right direction to actively deal with changes as they arise.

5 **They are applying technology to support their transfer pricing decisions.** No matter the transfer pricing policy, manual execution of the relevant intercompany payments can be a burdensome and, ultimately, risky undertaking, particularly as the volume of those payments grows. The leaders are automating these processes, in combination with robust policy-setting and governance regimes, to optimize efficiency and minimize compliance risks.

Don’t wait another day

While many leading Asset Managers have been carefully reviewing and developing strategies to address their changing tax and transfer pricing realities, experience suggests that perhaps not all Asset Managers are proactive.

This is no time for a ‘wait and see’ approach. Those that ignore the changes may likely find themselves facing missed opportunities, much bigger risks, and potential transfer pricing exposures in the future. The time to optimize tax and transfer pricing strategies is now.

“Some of the more tax-savvy asset managers have started to **recognize that their transfer pricing policies may be out of date.**”

Chairman’s message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Contributors

Anthony Brown
KPMG in Canada
E: adbrown@kpmg.ca
Anthony is a Partner in KPMG's Global Transfer Pricing Services practice in Toronto. Anthony specializes in the financial services industry and on financial transactions across all industries.

Sherif Assef
KPMG in the US
E: sassef@kpmg.com
Sherif is a Principal in KPMG's Washington National Tax Practice. Sherif has over 20 years of transfer pricing and extensive experience advising clients on a variety of transfer pricing matters.

Dr. Manuel Imhof
KPMG in Germany
E: mimhof@kpmg.com
Manuel is a Partner in KPMG in Germany. He has more than 11 years of international tax law and transfer pricing issues and focuses with clients in the financial services industry.

Chairman's message
Cover story
Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

When opportunity comes calling:

Using the deferral of IFRS 17 wisely

Mary Trussell, KPMG International
Ferdia Byrne, KPMG International
Brid Meaney, KPMG China

The original timeline for IFRS 17, with an effective date of 1 January 2021, presented a significant implementation challenge for many insurers and, as KPMG International's global benchmarking study *In It to Win It* showed, many were facing a struggle against the clock.

Chairman's message
Cover story
Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

The additional year brings not only more time — but an opportunity to better understand results and optimize performance on an IFRS 17 basis. The extra time also brings the prospect of delivering greater value from finance, by developing a road map to a better financial reporting capability and, as a minimum, containing future costs.

But the change also brings challenges. Some insurers would have liked a longer deferral and the additional year to enable entities to adapt to further changes to the standard, albeit aimed at reducing its complexity. So it's crucial that insurers don't take their foot off the gas, thinking that they will pick up the pace later: that multiplies risks and cost.

Instead, the opportunity now presents itself to be more ambitious in those areas where you can derive greater value from change and to better understand results in the new world.

Where can you drive more value?

On the commercial side, there are a number of areas you can focus on to help maximize the opportunity presented by the deferral of IFRS 17.

1 Present your business plan on an IFRS 17 basis; carry out what-if scenarios to really understand the implications to your results.

2 Analyze transition options and methodology choices, and re-price short-term, onerous contracts, to show the business in the best light. Develop a better appreciation of how you then tell your story to the market: How will your IFRS 17 results appear compared to your IFRS 4 results and how you've been communicating these externally?

3 Understand how you will revise KPIs and performance metrics to reflect IFRS 17. Will contractual service margin (CSM) generation tell your growth story, or will you continue to use existing metrics like Embedded Value (EV) and Value New Business (VNB)?

4 Develop an improved understanding of the drivers of your future results and potential sources of volatility, reflecting the mix of your products and which IFRS 17 models and approaches they fit within. Understand how future product changes and product mix could impact your results.

5 Use the time to make more deeply researched policy choices to identify the best outcomes for your business to depict your growth strategy and reflect your markets, products and distribution strategy.

KPMG professionals interviewed a number of analysts and synthesized their views on IFRS 17 in our survey *Can you see clearly now?*[1] Many are hungry for greater dialog with insurers on their plans for the upcoming changes.

On the operational side, in simple terms, the end-game must be 'Better, Cheaper, Faster'.

- Better, by offering more business-useful insights.
- Cheaper, because that's an imperative for every organization.
- Faster, to get relevant information to management quickly to steer the business.

There are a number of things you could be doing to maximize the opportunity presented by the deferral of IFRS 17.

While the additional year may not give you the time to fundamentally transform your end-to-end processes, why not use the time to really understand your current state, enhance wherever possible and develop a road map to overhaul the remainder, rather than just adjusting processes in a tactical way for IFRS 17? Spending the time to understand your data architecture, i.e. your data flows and

> "It's crucial that **insurers don't take their foot off the gas, thinking that they will pick up the pace later...** that multiplies risks and costs."

[1] https://home.kpmg/xx/en/home/insights/2018/12/can-you-see-clearly-now-fs.html

Chairman's message
Cover story Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

interfaces throughout your end-to-end processes, can help you understand what can be done to simplify, standardize and automate.

Use the extra time to better align your data between your actuarial models and accounting systems. Variances between actual results (from the accountants) and expected results (from the actuarial models) can have a direct impact on reported results. Enhance and transform your analysis of change process as IFRS 17 moves this process from a control to a fundamental part of the income statement. This requires a step change in the capability required.

A number of companies have still not even chosen the provider for their CSM solution. The deferral allows companies to get their CSM engine working to a satisfactory level and integrated into their architecture, i.e. getting data from actuarial cash flow models through to posting results to accounting systems and general ledger to support dry runs.

Spend time assessing how to enhance the chart of accounts to provide the necessary analysis, control and reporting outputs across reporting metrics, including tax. Typically, deficiencies in the chart of account manifest in end-user spreadsheets, and so understanding the design is an opportunity to simplify, standardize and automate analysis, control and reporting outputs.

Understand the critical path through your end-to-end reporting close process, and how much you can take off-cycle to give you some time to properly understand the results, especially in the early years.

Understand how your business planning, forecasting and management information (MI) processes will change in an IFRS 17 world, taking into account the key components of the new income statement and how they will react in different scenarios: the CSM release, the Risk Adjustment release and the investment result. IFRS 17 is based on expected values of these components, so for the in-force book, this will come down to understanding and anticipating variances against these expected values.

"While the additional year may not give you the time to fundamentally transform your end-to-end processes, why not **use the time to really understand your current state, enhance wherever possible and develop a road map to overhaul the remainder.**"

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Integration of accountants and actuaries

IFRS 17 is driving greater integration of accountants and actuaries into the Finance function and greater integration of actuarial reserving and pricing into general insurance companies.

In the Life market in the UK, the Finance function has combined actuaries and accountants, but in the US, Canada, Asia and elsewhere, actuaries typically sit in a separate function (or sub-function within Finance) reporting to the chief actuary. With IFRS 17 and the greater use of projections of future cash flows, explaining results will require closer collaboration between accountants and actuaries than they've ever worked before.

That collaboration is needed before IFRS 17 goes live in order to design and build these changes — and while that's underway, why not use that closeness of working to get accountants and actuaries working better together on current reporting — IFRS 4, EV, capital?

The same is true in general insurance, where it is critical to form an ever closer feedback control cycle, including business planning, pricing, claims management, reserving and capital to ensure emerging information is quickly identified and acted upon. Both actuaries and accountants need to shift their focus to providing insight rather than crunching data, and investment in automation to support the new basis of reporting is a key catalyst of that shift.

The new world is much more integrated and less siloed. Change has already begun. Professional qualifications don't limit or define people as they used to. Finance teams are now starting to include data scientists and data visualization specialists and actuaries as well as accountants. Modern finance teams, in insurance as elsewhere, need to blend skills in multidisciplinary teams.

The demands of IFRS 17 will further drive this trend: Take advantage of it to make your finance team fit for the future. Use the change now to grow your talent of the future.

An opportunity not to be passed up

Success requires preparation, determination and opportunity — and the deferral of IFRS 17 grows the size of that opportunity. CFOs and their teams can use the changes that IFRS 17 requires to enhance their finance capability.

While there may not be the time to transform the function if you haven't headed down that path already, at least seize the opportunity to understand your current state, map out the journey to become the finance function of the future and use IFRS 17 to get as far along that road as possible.

The extension of the implementation timeline provides the window of opportunity to do much more than many had accepted might be the case.

Seize the opportunity, because who knows when it will come again? ■

Contributors

Mary Trussell
KPMG International
E: maryhelentrussell@kpmg.com
Mary is KPMG's Global Insurance Accounting & Regulatory Change Leader and Global IFRS Insurance Co-deputy Leader. With over 30 years' experience, Mary brings deep experience covering the entire range of insurance markets, from life and health and personal lines to specialty risks and reinsurance, across Asia Pacific, Europe and North America. Mary advises clients on successfully navigating change to enhance their finance capability and business performance.

Ferdia Byrne
KPMG International
E: ferdia.byrne@kpmg.co.uk
Ferdia is the Global leader for Actuarial at KPMG and is a member of the global Insurance leadership team. With over 20 years' experience, Ferdia specializes in life insurance and has worked with various European multinational insurers. His areas of expertise include financial reporting, risk management and M&A. He has broad experience in various European insurance markets.

Brid Meaney
KPMG China
E: brid.meaney@kpmg.com
Brid moved to Hong Kong in July 2018 from KPMG in the UK where she was Head of Insurance. An actuary with over 25 years' experience in the life assurance industry, her deep expertise in finance and actuarial transformation is matched by personal experience of leading finance functions through change.

Chairman's message

Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Publications

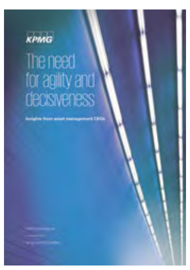
KPMG member firms provide a wide-ranging offering of studies, analysis and insights on the financial services industry. For more information, please go to kpmg.com/financialservices

Pulse of Fintech H1 2019
The Pulse of Fintech analyzes the latest global trends in venture capital, M&A and PE investment activity in the fintech sector. In this edition, we also include trends and insights around wealthtech, proptech, insurtech, regtech, cyber security, and more.

Asset Management: It's decision time
The Asset Management industry is facing complex challenges, but vast opportunities await and asset managers have big decisions to make. KPMG can help you adapt and make the bold choices that will lead you into the future. We can make better decisions together. **It's decision time.**

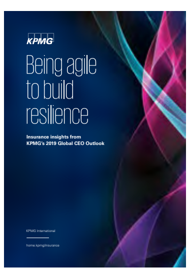
The future is open: Reshaping the banking experience
Banks today face profound industry challenges, even so, we believe the future is open with opportunities. This 10-part article series cover a range of topics related to technology innovation and disruption, providing practical insight into how banking executives can leverage the trends for sustainable competitive advantage.

Operational excellence in insurance
KPMG and ACORD launched a survey report on operational efficiencies to understand where insurance companies are on their transformational journey and where they are heading. A majority are falling behind and a lack of process standardization and strategic vision is the primary obstacle to future transformation efforts.

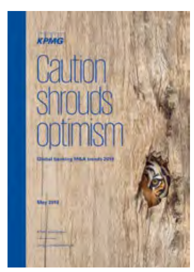


Global Asset Management CEO Outlook 2019
While they are confident about their immediate business prospects despite a fragile global economy, CEOs of the world's major asset management firms are alert to the need to adapt their business to reflect customer values and expectations, environmental risks and transformational technological change.

Global Banking CEO Outlook 2019 (video)
Banks are facing an uncertain future and their CEOs are addressing this by redefining resilience and focusing on agility in the ongoing pursuit of growth. KPMG surveyed over 100 Banking CEOs across the largest work economies to get their perspectives on how they are preparing their business for change and building resilience.



Global Insurance CEO Outlook 2019
Insurance CEOs are faced with a stark choice. In the face of unparalleled environmental, economic and technological change, they are looking to grow their businesses by creating the organizational agility to disrupt existing business models and challenge long-held market orthodoxies.



Global Banking M&A Trends 2019
This 2019 edition of the Banking Trends report provides a snapshot of 10 trends and opportunities affecting the banking M&A environment around the world. We analyze 7 key geographies and 3 high impact sectors, including China, ASPAC, US, Western Europe, Eastern Europe, Africa, LATAM, non-performing loans (NPLs), Fintech and Private Equity.

Global Banking Fraud Survey
This report looks at how banks and other financial institutions are identifying, assessing and addressing new fraud risks. It also provides a view into what investment is being made in technology and the right people with the necessary skills and governance to identify, prevent and detect fraud.

Mind the Gap: Women in Financial Services Leadership
Mind the Gap is a blog series that features interviews with Laura Hay, Global Head of Insurance, and women executives from the financial services industry around the world. Laura and her guests discuss their career progression, professional failures and successes as well as a variety of other topics.

Chairman's message

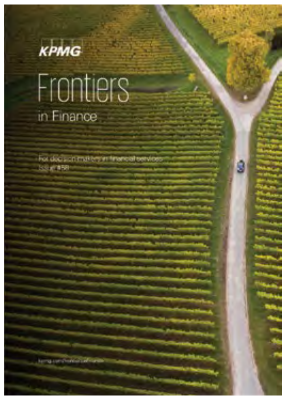
Cover story
Paytm: Solving problems to create opportunity

Creating efficiencies

Digital models take hold

Compliance-driven transformation

Missed an issue of *Frontiers in Finance?*



Back issues are available to download from home.kpmg/frontiersinfinance

Frontiers in Finance is a forward-looking collection of market insights, thought-provoking perspectives and sector-specific issues that impact key decision-makers of financial services organizations around the world. All articles are written by industry-leading and experienced professionals from across our Global Financial Services practice.

KPMG's Global Financial Services practice has more than 34,000 partners and professionals across our global network of 154 member firms, providing audit, tax and advisory services to the retail banking, corporate and investment banking, investment management, and insurance sectors. Each one of our professionals brings ideas, innovation and experience from across this vast network, to the benefit of each of our financial services clients around the world. We serve leading financial institutions with practical advice and strategies backed by world-class implementation. We believe our commitment to the industry, our sector-specific insights and our passion for serving our member firms' clients to the very best of our abilities help us stand out.

We welcome the opportunity to discuss how KPMG member firms can help you achieve your business objectives.

KPMG was ranked No.1 for Quality in Source's annual global survey of end users of consulting services. Source's customers include every single one of the world's biggest 20 consulting firms and is the leading provider of research, data, and strategic advice about the global management consulting industry. For more information, please visit: **www.sourceglobalresearch.com**

Chairman's message
Cover story
Paytm: Solving problems to create opportunity
Creating efficiencies
Digital models take hold
Compliance-driven transformation

Contacts

Mads Raahede
Partner
KPMG Advisory
Financial Services Lead
KPMG in Denmark
T: +45 52 15 02 66
E: mraahede@kpmg.com

Anja Bjørnholt Lüthcke
Partner
Head of Financial Services Audit
KPMG in Denmark
T: +45 52 15 00 69
E: anjabl@kpmg.com

Hans Jørgen Andresen
Partner
Actuary, Financial Risk Management
KPMG in Denmark
T: +45 52 15 02 55
E: hansjandresen@kpmg.com

Bent Dalager
Partner
Nordic Head of NewTech Management Consulting
KPMG in Denmark
T: +45 53 75 30 00
E: bdalager@kpmg.com

Mads Jæger
Director
Financial Services Advisory
KPMG in Denmark
T: +45 61 96 66 69
E: majaeger@kpmg.com

Søren Vörtz
Director
Financial Services Advisory
KPMG in Denmark
T: +45 50 87 96 13
E: svoerts@kpmg.com

Kenneth Ipsen
Director
Financial Services Advisory
KPMG in Denmark
T: +45 50 87 96 41
E: kipsen@kpmg.com

Kristoffer A. Bork
Director
Actuary, Financial Risk Management
KPMG in Denmark
T: +45 40 74 48 55
E: kbork@kpmg.com

Gregers Frank
Director
Actuary, Financial Risk Management
KPMG in Denmark
T: +45 52 15 02 39
E: gfr@kpmg.com

Jan Per Jensen
Director
Audit, Financial Services
KPMG in Denmark
T: +45 52 15 00 45
E: janperjensen@kpmg.com

home.kpmg/socialmedia

Designed by Evalueserve.
Publication name: Frontiers in Finance — Denmark
Publication number: 136518-G (Denmark)
Publication date: October 2019