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Banking in the new reality

Six trends shaping the industry

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Introduction

COVID-19 has dramatically reshaped the world in which we live, with tumultuous economic and financial effects running alongside the public health emergency. At the height of the outbreak, banks across the globe played, and continue to play, a fundamentally important role supporting businesses and families by administering government-backed loans, providing additional liquidity and rapidly installing forbearance measures.

In many ways trust in banks is at an all-time high, and they are being viewed by customers and businesses in a positive light. The key now is to retain those gains and build on them.

KPMG banking and capital markets professionals have been reflecting on — and widely discussing with banks — the nature of the disruption. **We have identified six macro themes that have accelerated due to the pandemic and are now pivotal to banks' future success.**

To thrive in the new reality, banks will need greater connectedness across their front, middle and back offices than ever before. Being truly customer led, regardless of the type of bank — retail, commercial or investment — will require reimagined distribution and operating models, harnessing an increasingly digital economy and maximizing new ways of working, while at the same time managing costs and new risks, and placing all aspects of ESG into their core strategy.

KPMG experts from across our global network bring their insights into how banks can thrive during extraordinary uncertainty. **The time for action is now.**

Judd Caplain
Global Head of Banking and Capital Markets
KPMG International

New distribution channels reconfiguring the landscape

1

As society becomes more cashless and digitization accelerates, banks will need to evaluate their branch networks and ask themselves fundamental questions about what their physical outlets are actually for. Are they sales points or service centers? Core to the brand or nice to have? In a much more digital model, products and services may need to be reframed, allowing greater degrees of self-service, enhanced product functionality and fulfilment, and a new approach to selling and advertising to attract customers.

Our predictions:

— Branch networks will be slimmed down and undergo significant change

— Digital channel functionality will develop rapidly and at scale

— Call centers will be re-evaluated and re-purposed

— Banks will introduce new integrated e-commerce suites to bring more small businesses online

— Cash may stage a partial recovery but is on a terminal decline

Actions for banks to consider

1 **Rapidly assess branch networks and call centers**

A small window of time exists now for experimentation and review, before a new normal template begins to appear. Clearly defining the role of branches and contact centers is one of the critical questions facing banking in the new reality.

2 **Accelerate digital infrastructure development**

Programs to extend and improve digital delivery — through customer facing digital channels and the associated functionality, core banking platforms, IT systems and the cloud — need to be accelerated and scaled beyond individual products or channels to become enterprise-wide.

3 **Bolster data and analytics capabilities**

With so much more data in circulation through the 'digital default', it is essential to have the right data and analytics tools in place to leverage the information. Machine learning and AI capabilities will be needed to drive effective personalization and customer engagement.

Harnessing the shift to a digital economy

2

As we accelerate to a global digitally connected economy, banks must operate across virtual and physical domains seamlessly. They will need to harness the potential of new electronic payment mechanisms, digital currencies and contactless payments as use of cash rapidly declines. But as much as this creates opportunity, it also poses threats — with a generation of new technology-based service providers coming into the market, banks may need to devise strategies to prevent themselves from becoming disintermediated. They must find ways to remain relevant to their customers and create new use cases for payment revenue opportunities.

Our predictions:

- Banks will significantly increase their deals and partnerships activity with agile new players in the payment space
- There will be increasing numbers of large scale alliances
- Fintechs and new players will continue to shake up the market
- There will be a race to launch a central bank digital currency (CBDC)
- Operational resilience will be a key focus, and more non-core activities will be outsourced

Actions for banks to consider

1 **The pace of change is quickening — invest and forge partnerships**

In the wake of COVID-19, the change that would have happened over the next 5 years may now take place in the next 24–36 months. Are you actively building capability and looking for partnership and acquisition opportunities in the rapidly evolving payments ecosystem?

2 **Outside-in thinking and new skills will be needed**

To keep pace, banks will need to innovate through the lens of changing lifestyles, evolving business processes and emerging smart technologies, rather than taking a traditional product approach. New skills will be needed in the organization, with fintech and entrepreneurial mind-sets at a premium, and a 'fail fast' culture may be needed to shorten time to market.

3 **How will banks make money from payments in the future?**

With increased competition from new players and services, and historically low interest margins, profitability will be hard to come by in payments. How will you respond to this and what new revenue streams can you create in related or adjacent areas?

4 **Data and platforms will be at the core of change**

Increasingly, transaction data will connect with other information to support new digital service development. Software is traversing traditional sector or retail/ wholesale payments divides and importantly connecting "real economy" use cases with financial services. These are the new business models owned by Go-Jek, Klarna, PayPal and many others. Banks will need to compete through their data assets, which will likely result in material acquisitions of data capabilities in order for them to retain relevance in the digital economy.

Cost priorities reimagined, new operating models emerging

3

In an exceptionally low interest rate environment, operating expense will likely become an ever greater area of focus. Banks will need to find a way of decreasing costs while also building capability to support growth. A focus will fall on leveraging technology to achieve both of these aims, through greater use of automation and AI. Simultaneously, banks can more aggressively evaluate their operations by moving to greater use of shared service utilities owned by consortiums or third parties, as well as managed services and outsourcing. Everything could be up for debate as banks look for the operating model of the future.

Our predictions:

— Shifts in cost and operating dynamics post-pandemic will drive bank cost bases up

— Banks will need to review every aspect of their operations — with branches and property being an obvious focus

— Service centers and call centers will change — but this is likely to push costs up

— Staff costs, productivity and remuneration packages will be reviewed

— The use of shared service utilities owned by consortiums could make a come back

— Increased digital adoption

— External spend goes under the microscope

Actions for banks to consider

1 **Decisive action is needed — nothing should be off the table**

With income set to be squeezed, bad debt provisions rising, and cost bases enlarged, small incremental measures will not be sufficient. COVID-19 has created an opportunity to re-engineer operations and processes — bold thinking is needed.

2 **Cost reshaping must be sustainable and not reduce resilience**

Effective transformation is about identifying the right costs to reduce — not all or any costs. It is about cutting fat, not muscle. There must be absolute clarity about which activities and functions are essential for resilience. Efforts must create value, not destroy it.

3 **Clarity and governance — make as much difference as what a bank does**

Achieving clarity around cost management, transformation execution, decision-making, accountability and governance creates as much value as issues of design and engineering (business & operating model, core systems, digital, cloud). Start by achieving this clarity — it can make perhaps 5–10 percent of difference. Move on to design and engineering issues afterwards.

New ways of working becoming the norm

4

COVID-19 has seen a cross-sector working from home 'revolution' — including in banking. Going forward, banks should identify the optimal mix for the operating model and ensure they have sufficient infrastructure to facilitate long term mass flexible working. In turn, this means that the purpose and use of corporate real estate will need to be re-evaluated. At the same time, the labor force is likely to become ever more automated, with resiliency paramount. Organizational culture and leadership, on-boarding, training, upskilling, and the attraction of new talent — together with tax implications due to reduced global mobility and higher levels of remote working — all need to be factored in to a complex set of dynamics.

Our predictions:

— Working models will be changed permanently as corporate real estate is also reimagined

— Offshore service center disruptions will lead to changed approach

— Automation will be utilized more widely

— Leadership and management skills needed will shift

— Investing in the right support and training will be key

Actions for banks to consider

1 **Listen and reflect — don't rush back**

Banks have a once in a lifetime opportunity right now to review how they operate and think about the future. Listen to your staff and your customers. Don't waste the crisis. Think creatively and consider all options.

2 **Leverage what this period has proven**

COVID-19 has proven that working in a different way is possible — now, focus on how that can be continued sustainably. Challenge your own culture and thinking. There is a huge opportunity to decisively accelerate shifts that were already happening — workforce reshaping, increased automation, digitization. Design for people and their ways of working, throughout their day and throughout their career. Enable experiences, with an ecosystem of tools and technologies working together. Shifts in technologies should consider the combined impact of features and integration. Now is also the time to ensure that policies supporting diversity and inclusion are high on the agenda.

3 **Support your leaders to drive change**

It will be crucial to invest in and support all your people. But your leaders are particularly critical because they are the ones who will need to drive and direct change. Think about how you can help them, what tools or training they need, so that they can truly support their teams and bring everyone on the journey.

Writing a whole new risk management playbook

5

If there is one thing that COVID-19 has taught us, it is that almost anything can happen. Banks will need to fundamentally re-evaluate their resiliency across the complete spectrum of risk — operational, liquidity, capital, market, and credit risk — to model for the next unforeseen event. As we enter a likely recessionary period, regulatory requirements could rise. How much capital should banks hold over and above regulatory mandates? Are their customer portfolios sufficiently diversified? Meanwhile, as banks increase the use of AI and digital technologies, are they cyber secure? New risk models and strategies need to be developed as well as processes and protocols to accompany them.

Our predictions:

- Banks' risk models will need to continue to be reviewed and recalibrated, while credit portfolios will need to be dynamically managed
- Data availability and quality will need to be improved across the Risk function and with related functions such as Finance
- Advanced data & analytics and AI will hold the keys to value
- Aspects of operational risk will remain under the microscope, and robust cyber security will be critical
- In a tough economic, trading and lending environment, growth and acquisition opportunities may present themselves to those banks with the strongest risk management regimes

Actions for banks to consider

1. **Invest in technology and data**
Better data availability and quality, enhanced analytical capabilities informed by AI and machine learning, and faster reporting — these must be the hallmarks of a Risk function of the future.

2. **Credit risk management must be at the forefront**
In a potentially worsening economic environment, credit portfolios must be actively managed on a disaggregated basis. Banks must be able to understand where not only business sectors but individual corporate clients and personal customers are in their own post-COVID-19 journeys, what their cash flow and recovery projections are, and the risks they represent. Risk functions must be integrally connected with the operational and sales sides of the bank.

3. **New models for operational risk and resiliency to cope with the unexpected**
Banks proved their resiliency through the height of COVID-19 – and must be able to cope with whatever the future brings. With further lockdowns — on a local or even national level — very much a possibility, operations must be able to flex between physical and virtual footprints or a hybrid of the two. In a more digital world, cyber security and the protection of customer data will become more important than ever — key issues on which a bank's reputation could depend.

4. **Keep attuned to opportunities for growth, not just risk mitigation**
Dynamic, predictive models to better understand customers and the associated risks could also drive opportunities to create competitive advantage and growth. Corporately, strategic acquisition opportunities could also arise as the fallout from COVID-19 unfolds.

Values and purpose front and center

6

As governments, businesses and citizens start to look towards the new reality of life with COVID-19, considerations related to environmental, social and governance (ESG) issues are central to the agenda. The days when financial institutions were almost exclusively evaluated by their growth, profits and go-forward prospects are receding. Today, what customers, investors and stakeholders increasingly want to know about — alongside financial strength — is the company's culture, values and purpose. Societal responsibility, ethics and support for progressive climate related products and services are paramount. Much progress was already being made pre COVID-19 — banks need to retain these gains and build on them for the future. At the same time, as banks become more digitized and the world moves towards a cashless society, banks may need to ensure that no one gets left behind.

Our predictions:

- Having an integrated ESG strategy will be vital for financial institutions
- All components of ESG will be essential
- The environmental and climate change agenda will come strongly back into focus
- How organizations acted during the pandemic will have ramifications for how customers, stakeholders, investors and employees judge them long into the future
- For those banks that don't pursue a strong ESG agenda, the consequences could be severe

Actions for banks to consider

1. **Put ESG at the very heart of what you do**
   It cannot be a standalone or separate lens through which things are viewed. It must be integrated holistically from the beginning in how they operate, part of the way interactions with customers are framed and how strategic and commercial activities are assessed.

2. **Use ESG as a practical and value-adding tool**
   It is a common misconception that ESG considerations can 'kill deals' — in fact, it helps banks understand and price risk. It is very practical and, used in the right way, generates significant commercial value.

3. **Take bold action, now**
   COVID-19 has accelerated the momentum and through it ESG issues will increasingly set the bar for how banks are assessed. Review where you are now and where you want to get to. Articulate your ambition and vision. Consult with your stakeholders and bring them on the journey.

Explore more

KPMG professionals provide further insights into the trends shaping the banking industry. To read more, click on the images below.

Opportunities abound in a new world of banking distribution

This article explores the acceleration to digitize banks' distribution channels and how this will forever change branch networks and how they interact with customers.

Workforce transformation holds huge possibilities for banks

Banks mobilized quickly in the face of COVID-19 to keep employees and customers safe, in this article we explore how they can optimize these new working models.

Banks look to preserve their place in tomorrow's digital economy

As banks look to invest and innovate, there are three key themes banks' and payment companies should embrace in order to be competitive in the digital economy.

Banks unlock the power of data to manage risk in the new reality

In this article we look at how banks with dynamic risk models based on data and smart analytics will be more resilient in the COVID-19 new reality.

Banks overcome pressing cost challenges to be fit for the future

As cost pressures mount due to COVID-19, clear governance around cost management, transformation execution and decision making is essential for banks.

Banks going further, faster on the ESG journey

Changing customer and investor expectations reflect a new way to think about the environmental, social and governance (ESG) agenda and how it can create value for banks.

For more insights visit **home.kpmg/banksnewreality**

“As customers shift to online channels and we accelerate to a digital economy, banks have a window of opportunity to expand their digitization efforts. The time for action is now.”

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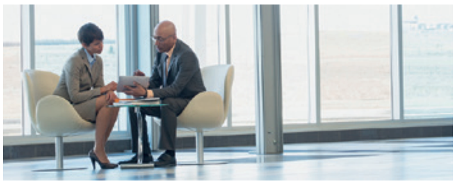

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