Regulation, trust and growth

Three big questions for the financial services sector

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PwC, in partnership with the Financial Services Council, has surveyed a group of the Council's CEO members, to better understand the financial services industry's major concerns and opportunities for the year ahead. Three clear themes emerged:

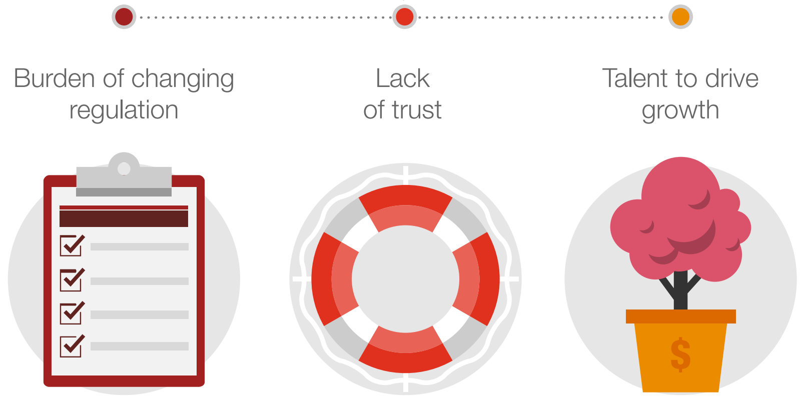
- bearing the burden of rapidly changing regulation
- attracting talent to drive growth
- building trust in the sector.

These findings reinforce trends identified in PwC's global CEO survey that was released earlier this year, suggesting that Australians face the same hurdles as financial services professionals around the world.

The majority of financial services CEOs believe that the burden of regulation is increasing, and are concerned about the cost of compliance. More worryingly, they are not convinced that current regulations are actually providing the value that consumers seek, or supporting efforts to earn consumers' trust. It's increasingly clear that industry and regulators need to find other ways to achieve closer collaboration, leading to regulation that adds real value, meets the needs of consumers, and supports rather than hinders good business, innovation and growth.

One such opportunity is to reimagine what is possible through the rapid emergence of RegTech (regulatory technology) and its potential to transform compliance and risk management practices: lowering costs, improving compliance, and enabling better decision-making. This could benefit both consumers and the industry.

Three key themes facing Financial Services



CEOs shared their concern that a lack of trust can harm their companies' bottom line; efforts to rebuild trust are among their top few priorities for the next two years. Although CEOs are ultimately responsible for their firms' culture and reputation, and strategies to protect and strengthen these are absolutely essential, building trust remains a critical priority throughout the industry – and no organisation will be able to solve it in isolation. There is an acknowledgement that a cohesive and powerful strategy to achieve this will be required.

Regarding performance, we were pleased to see the optimism of the CEOs, with 82 per cent feeling confident about their prospects for profitable growth over the next two years. We firmly believe that growth in the financial services industry, especially in areas benefiting Australia's ageing population, is important for national prosperity.

While much of the regulatory focus on the industry in recent years is hard to argue with, CEOs must find a way to engage more closely with their existing customers, and with more of the population who are currently not using financial advice, products and services that meet their particular needs.

Seventy-eight per cent of Australian financial services CEOs believe innovation is important to their organisation's future, particularly in areas that require human ingenuity, not just better automation. New products and services, an improved customer experience, and better distribution channels all require people with diverse skills if the company is to truly excel. Finding and retaining well-qualified employees is rightly at the forefront of CEOs' minds.

Next steps for CEOs

We suggest that CEOs give priority to the following activities over the next 12–24 months:

- Embrace RegTech: look for opportunities to make compliance add value, work hard to bring scale and efficiency to standardised tasks, and cooperate more closely with regulators to find the win-win in regulation.
- Remove the barriers to innovation everywhere in your organisation, and make it easier for your staff to do business and help customers.
- Continue to seek out and nurture people with diverse skills and talent, by forming new types of partnerships and by augmenting core capabilities.
- Be relentless in efforts to rebuild trust. The best financial services CEOs will truly understand and act on those forces that influence customers' trust in their organisations – and in the industry at large – not just over the next two years, but always.

Next steps for FS CEOs

Greater scrutiny and regulation

Financial services organisations have been under close regulatory and public scrutiny since the financial crisis, which occurred almost a decade ago. This scrutiny has intensified in response to instances of poor practice that have harmed customers. Regulators continue to receive increased funding to supervise an industry that has suffered a loss of trust.

Some organisations acknowledge the importance of winning back the trust of their customers. But the industry as a whole has been slow in responding to this scrutiny, and in meeting broader community expectations. Regulators have responded by introducing new and more stringent regulations that they believe will protect consumers, as well as taking enforcement action.

The majority of CEOs surveyed acknowledge that regulation already brings significant and increasing repercussions for their organisations. They are trying to keep pace with rapid regulatory change, while simultaneously trying to deliver value for customers and reduce operating costs. Forty per cent of CEOs are concerned that this constant change increases the risk of their organisation not complying with relevant laws and regulations. Constant regulatory changes are also raising the cost of compliance, which is a concern for almost half of the CEOs surveyed.

On top of this, many feel that new regulations are not delivering value or the desired trust for customers and the financial services industry. There is a growing concern that the rate of change is causing gaps to emerge between actual business practices and regulatory expectations.

Despite these growing concerns, 56 per cent of respondents state that the nature of their interactions with regulators has remained unchanged over the past 12 months. This may suggest that opportunity exists for regulators and organisations to work more closely together to help build customer trust, experience and value.

In responding to the changing regulatory environment, 40 per cent of CEOs say that strengthening policies governing organisational conduct, and improving customer experience, were the two most immediate needs. Seventy per cent of CEOs feel that engaging more closely with customers and making sure the organisation complies with obligations are the most important actions they need to take to maintain or restore trust in the sector. Almost half agree that it is critical to take action to maintain or restore customer trust within the next two years. It is clear that winning back trust in the industry is a priority for most financial services organisations.

New solutions to the problem of accelerating regulatory change

Regulation can bring opportunities

With regulatory change showing no signs of slowing down, the continuing problem for the industry is knowing how to meet the demands of regulators in a sustainable manner, without diminishing the value and trustworthiness that customers expect. Although re-evaluating policies and procedures and instilling the right culture will always be important, organisations must think beyond these traditional approaches when responding to regulatory change in the future.

For the past few years, RegTech has been discussed and debated as a new solution to the problem of accelerating regulatory change. Robotics, machine learning and data analytics have the potential to disrupt and transform how risk and compliance are managed, reduce the risk of non-compliance, and help organisations earn the trust of their customers in a sustainable manner. Imagine a world where regulatory management uses technology to make faster, targeted and more customer-focused decisions, and where organisational policy-making is automated through the use of artificial intelligence.

However, RegTech applications are yet to be fully explored and implemented by many asset and wealth management organisations, a point echoed in our recent Global asset and wealth management CEO survey.

Although the relevance and appropriateness of regulatory change will continue to be debated, compliance does not have to be seen as a burden. Instead, it can bring opportunities to create business value for customers, and earn their trust.

Now is the time for CEOs to challenge their leadership teams on whether the organisation is doing enough to think differently about how to respond to regulatory demands and community expectations. Organisations must work hard to demonstrate that they are complying, and to be perceived as credible when dealing with regulators. They should provide constructive feedback and alternative solutions in order to build trust and customer value.

Confident about growth, but foreseeing difficulties

Most Australian financial services CEOs are optimistic about future growth, with 82 per cent reporting confidence about their organisation's prospects for profitable growth over the next 24 months. But there will be obstacles on the way.

We were pleased to see the optimism of the CEOs. Industry growth, especially in areas benefiting Australia's ageing population, is important for national prosperity. The more the industry can offer compelling advice and products that help Australians save for and navigate their retirement, the better the future for customers and the industry. While this may seem self evident, there is a way to go as a number of the possible impediments are beyond the industry's control.

Government support for retirement income reform and the long-term integrity of the superannuation system, regulation that encourages good business, and stable global markets, will all help determine whether CEOs' expectations for growth are met.

Across the industry, we see a strong focus on reducing costs and reviewing business portfolios. This is understandable if incumbent players are to be ready for growth; shedding unnecessary business infrastructure and costs, and unprofitable businesses, are both essential. However, equal or even greater effort must be applied to driving growth.

Possibilities for growth that should be explored include:

- greater involvement in the area of retirement income
- better and more profitable advice and products
- smarter and more global asset-management services, that break free of the commoditisation we've seen over the past few years
- mitigation of life risk through health-related services
- making the most of capabilities by forming partnerships with other organisations
- better experiences for customers at every stage of their life.

To take advantage of these opportunities, financial services leaders must further refine their talent strategies to promote diversity, and adopt new ways to recruit and retain the best possible workforce. Trust is very important here, since an industry or company with a solid reputation will attract more star players.

Trust – no fleeting issue

Australian financial services CEOs recognise the need to build trust. We found that 71 per cent of them believe trust is critical or important to their organisation's future success, and rank trust among the five biggest issues of concern faced by the industry and its customers (ahead of low interest rates, residential property market conditions and global geopolitical uncertainty).

Although it can be difficult to understand the reasons behind consumer mistrust at a time when reported levels of customer satisfaction are high, building and protecting trust is no fleeting concern. The industry needs to do better in attracting the discretionary savings of Australians and proving its worth as 'a driver of alpha' and deliverer of sustained value to customers preparing for – or already in – retirement. Customers may well be satisfied with their current services, but will they demonstrate their trust in the industry, regulators and government to help them in the future by purchasing more products and services?

Given the complexity of measuring and repairing the causes of declining trust, the current gap between awareness and action in the industry is understandable. Nevertheless, we believe that viable and effective strategies exist and will increasingly find their way into the language and practice of financial services business. At a minimum, CEOs must:

- clearly articulate their organisation's purpose and value
- be relentless in making their entire organisation's strategy and behaviours consistent with this purpose and value
- deliver 'what it says on the label' – the expertise and competence you promise to your customers are, without exception, the expertise and competence you must provide to your customers
- understand that customer experience is crucial to trust. The steps you take to remove frustrations and avoid bad experiences, and to act quickly and with integrity when such incidents inevitably occur, should be at the core of what you do.

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