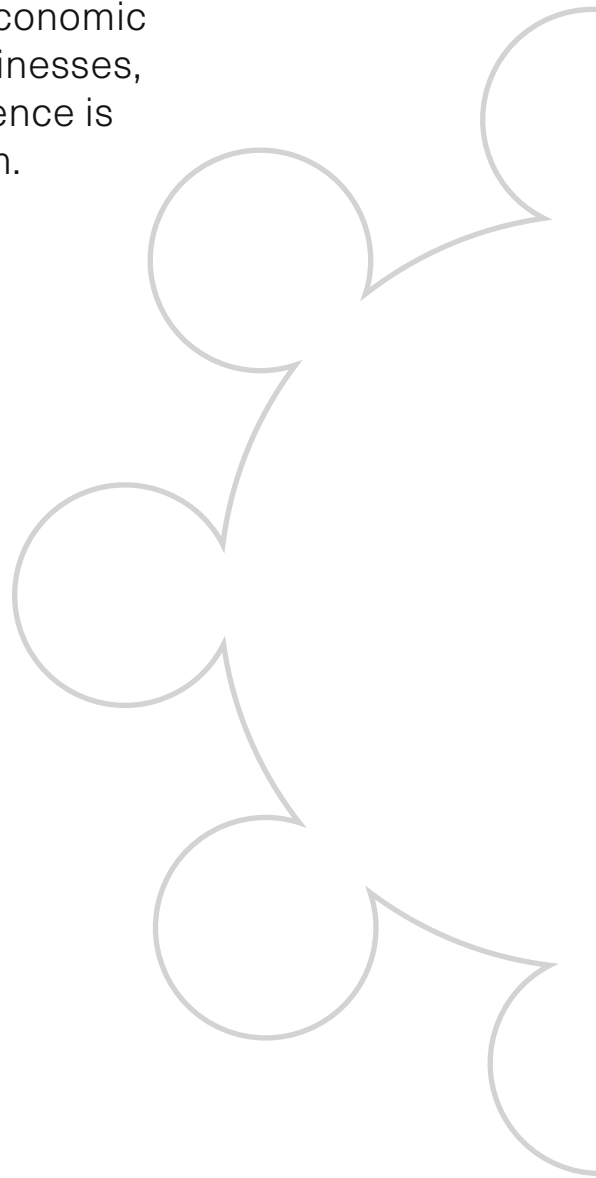


# Financial services



New Zealand banks entered the crisis in a strong position both financially and socially. Lessons learnt and changes following the Global Financial Crisis meant that banks are well-capitalised and prepared to weather this storm. The Government has encouraged banks to use their capital buffers for lending to businesses and households to help them manage through this crisis, and the banks have given repeated public assurances that they are prepared to do this.

It is clear that banks, and the financial services sector generally, are going to be key to New Zealand's economic recovery and will be relied upon heavily by businesses, the public and Government in ensuring confidence is maintained in the New Zealand banking system.



Banks are finding themselves at the forefront of supporting customers through COVID-19 by delivering government initiatives of financial relief for consumers and SMEs, including payment holidays and interest-only mortgages and the business finance guarantee scheme.

By the first week in April, one million people were being supported by the government wage subsidy. At the beginning of May, over 100,000 people had requested a deferral or reduction of their mortgage rate.

This brings some key practical challenges for the banks as they balance supporting their customers with a sustainable business model. Front line staff need to show empathy and compassion for customers while also dealing with some seismic shifts to their BAU operating model. This emerging trend is something the industry will be facing for years to come.

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## People

Financial services were largely deemed to be essential so were able to continue operating even during full lockdown. However, there were fundamental changes to how business was done. Branches were shut and the vast majority of staff were required to work from home. This caused initial challenges due to available bandwidth and hardware, as well as working through compliance requirements and data privacy aspects.

Then came the influx of customer queries about mortgage deferrals and potential financial hardship. While the initial flood of enquiries has passed, we expect the number of customers dealing with financial hardship and insurance claims as a result of the crisis to continue so organisations may need additional resource for these frontline roles. There may be opportunity to collaborate with industries with high levels of customer service agents who have been negatively impacted by the crisis and forced to reduce their headcount to transition people from one to the other, travel to banking for example.



## Digital is not optional

The shifts required to operate in a lockdown situation saw the speeding up of digital adoption both internally and externally. In one institution an internal instant messaging platform that had been debated for 18 months was rapidly rolled out. Online collaboration tools with virtual whiteboards were used to design product and process enhancements. Customers have been encouraged towards self-service online apps.

As people become more comfortable conducting their basic banking digitally, this will increase the willingness to consider more complex transactions such as mortgages or investment planning online. Branch networks have been redesigned over the years as visitors decline, this will continue to evolve as organisations consider the role of branches in servicing their customers and the communities they are part of.

Banks have been trying to move customers away from traditional channels and on to digital platforms for a while now and the economic crisis caused by COVID-19 has been a catalyst for rapid digitisation. This was also seen in China as a consequence of the SARS outbreak in 2003 when many were reluctant to leave their houses and preferred to interact and purchase online.

## Regulation

One of the first things the financial services regulators did was remove pressure on the banks and insurance companies by granting additional time to meet regulatory milestones. This was certainly not intended as a demonstration that regulation was any less important, simply an understanding that the internal resources were needed elsewhere as the sector struggled to adapt to the constantly evolving situation.

The regulatory requirements that were put in place following the GFC have certainly enabled banks to be in a much stronger position to cope with an economic crisis, and demonstrates the need for similar measures around capital requirements and stress testing to continue for the entire sector.



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## Political

The Government sees the financial services organisations as pivotal to New Zealand's economic response and recovery at this time of crisis. The banks have been working closely and collaboratively with the Government, regulators and each other to take a unified position.

The Reserve Bank and the Financial Markets Authority granted the banks additional time to meet milestones within the ongoing regulatory programmes of work to reduce some of the pressure put on the workforce dealing with increased customer demand at a time they were also dealing with a significant shift to their working environment and norms.

We expect to see increased regulation and political oversight given higher debt levels held by businesses and consumers. There are high expectations of how distressed customers are treated. Financial services organisations are going to need to have clear strategies to manage their interaction with Government and be ready to defend their positions and decisions taken.

While the banking sector is currently familiar with this level of regulation and oversight, it will increasingly apply across the sector.

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## Economic

While the banks are in a strong financial position compared to most other industries, there are serious challenges they will have to face into in the future.

Although banks are required to undergo regular and extensive stress-testing, this is not the case across the whole financial services sector. The insurance sector is under increased pressure to demonstrate levels of capitalisation and the ability to deal with the impact of adverse events.

However, this economic crisis is like nothing seen before and the Expected Credit Loss (ECL) impacts are expected to be significant, particularly across some of the worst affected industries like tourism, hospitality and retail. The existing models are inappropriate and unreliable in dealing with this situation as they draw on pre-COVID-19 data and assumptions that are not as relevant in the current reality and therefore need to be continually reviewed and adjusted.

The Official Cash Rate (OCR) is currently at 0.25% and will remain there until at least March 2021. This is expected to cause immense pressure on banks' margins and ability to remain profitable.

Economic downturns usually increase bank deposits as customers shy away from investments that are perceived as more risky. Banks have not cut their retail term deposit rates as hard as the Reserve Bank has cut the OCR as they protect their stable retail funding base. We expect to continue to see good levels of bank deposits, however the current low interest rate environment means there is strong pressure on margins and banks may need to look for alternative sources of revenue.

## Social

The New Zealand banks are in an enviable position with regard to the trust and respect that Kiwis place in them. The Colmar Brunton Corporate Reputation Index 2020 places two of the major banks in the top 20 most reputable New Zealand corporates. Banks do not appear in equivalent indices in Australia, the US or UK.

This position demonstrates the need to balance power with responsibility. The financial services sector is expected by Government and citizens to 'do the right thing'. The focus on conduct and culture across the financial services sector is even more important when businesses are being judged on their response to the COVID-19 crisis.

In times of financial stress it is imperative that customers understand the financial options available to them and the implications. Early enquiries to the banks following the Government's announcement of a package to include a mortgage holiday for personal and SME customers whose incomes had been affected by the crisis showed a lack of understanding with many customers thinking the Government was going to pay their mortgage for them.

While the deadlines to comply with CCCFA and FSLAA requirements have been extended, the focus on conduct and good customer outcomes has not diminished.

Does the financial services sector need to collectively tackle the low levels of savings, high levels of household debt and lack of retirement planning that are common in New Zealand? While many organisations have education programmes as part of their CSR programme, the enquiries fielded when KiwiSaver balances started to fluctuate demonstrates that many customers are potentially in the wrong fund for their risk appetite.

Research published last year forecast that New Zealanders would save -1.23% of their disposal income. New Zealanders are among the world's worst savers, ranking 26th out of 29 countries based on data from the OECD, and this was before the impact of an economic crisis hit. How do we encourage more New Zealanders to have the traditional three months' worth of salary saved as a financial cushion? This crisis has demonstrated the need for people to invest time and energy in financial planning for their future.



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## Technology

There has naturally been an increase in the uptake of digital technology following this period of lockdown. With much less opportunity and desirability to conduct business face to face there has been an emphasis on contactless transactions. When bank branches were only open for short periods of time, customers were being strongly encouraged to use online or phone channels. Organisations that have invested in their automated and self-service digital capability have been reaping the benefits of being able to handle customer queries.

Internally, staff working remotely has highlighted where inefficiencies or gaps exist in processes and rely on manual steps thereby slowing down response times. Requests that normally involve the customer completing and signing a hard copy of a document were reimagined to reflect the impracticalities of this process during higher alert levels. Teams have been working on creating forms that can be completed and submitted online, but there is also work needed to ensure the completed form is then available to the right team in a way that can be processed.

Business continuity plans in most financial services organisations did not anticipate the whole workforce working remotely at the same time. Some organisations initially struggled with having enough bandwidth available and needed to prioritise access to frontline staff during the normal working day, leaving other employees needing to work outside of their normal hours.

As customers become more comfortable with transacting online, there is an opportunity to utilise technology in more complex transactions such as mortgages, investments and insurance planning. Simple shifts include using video-conferencing to replace face to face meetings. Dealing with 'robo-advice' models which replace advisors' judgment with automated low-fee investment platforms offering asset allocation and portfolio rebalancing could be more attractive to customers as their digital maturity increases.

Relying on technology rather than face to face transactions will mean adapting processes for identity verification and signature confirmation that will not jeopardise Anti-Money Laundering or Countering Financing of Terrorism legislative requirements. Online only banks in the UK for example, ask for a video of the person next to their photo ID to confirm identity. Any changes to normal practices of what and how verification is accepted, and within what timeframes are needed, will have to meet the regulatory requirements. Appropriate controls need to be put in place to ensure this.

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## Legal

As in the rest of the world, financial services regulation is only going to increase.

Despite the additional time granted by the Reserve Bank and Financial Markets Authority to financial services organisations to comply with existing regulatory programmes, this is not an indication that it is less important. In fact, the reporting required by the regulators demonstrates that it is more critical when dealing with financially distressed customers to maintain high standards of conduct.

Organisations need to consider how to maintain compliance and controls while people are working remotely. Monitoring and oversight activities may have been suspended whilst in crisis mode, but it is critical to ensure that impact of this is understood and mitigated. A review of how these activities are completed may be necessary to accommodate the different working environment that embraces a hybrid model of remote and office-based working.

While banks are currently working towards complying with regulation to ensure certainty of being able to operate without reliance on off-shore systems or resources, all financial services organisations have seen the challenges involved in off-shoring critical functions and the impacts of this during a crisis situation.





## Environmental

The economic crisis caused by COVID-19 has reinforced the need for financial services organisations to be good corporate citizens. The importance of 'doing the right thing' is critical to the role that these organisations are playing both in the current situation and being part of the economic recovery. Organisations are being judged by stakeholders on how they are behaving through this crisis.

The banks in particular are being relied on by the Government to take a lead, and with great power comes great responsibility.

All this leads to increased scrutiny by stakeholders. There will be increased pressure to respond to the shift in stakeholder values, concerns and expectations by demonstrating social purpose, not just talking about it.

As large employers, the banks in particular are aware of their responsibility to their workforce and connected eco-systems. This crisis has created vulnerable staff as well as vulnerable customers, and there are plenty of opportunities for financial services organisations to have a positive social impact. While inclusion and diversity initiatives may seem like a 'nice to have', at the moment actually having empathy for and understanding of other people's circumstances is more important than ever.

The lockdowns around the world due to COVID-19 have clearly demonstrated the impact we are having on our environment and how quickly it can recover when there are less cars on the road, factories working and aircraft flying.

Financial services organisations are not alone in needing to take responsibility for investigating where changes can be made to continue with some of these positive changes. More remote working means less people needing to commute to and from work as well as potentially a smaller property footprint. The broader use of video-conferencing will result in less travel. These are all potential cost savings, as well as having a positive impact on the environment.



## FADES analysis

**Financial:** banks in New Zealand have strong balance sheets and significant liquidity buffers as a result of changes made following the GFC. This has been repeatedly stated by the Reserve Bank as well as the individual banks.

However, the impact of increased credit impairments and margin pressure will mean that banks and other financial service organisations will need to consider how they can save costs and generate revenue in this current low interest rate environment.

Financial services organisations should seek to understand where there are potential cost savings to be made. The changes brought about from the COVID-19 crisis will have shown up where expenditure is not as necessary as previously thought. Travel costs will have been greatly reduced as people become more competent and comfortable attending business meeting via video-conferencing, rather than insisting being physically present. The size of physical real estate could be reduced now the ability to work remotely has been thoroughly tested.

One major bank CEO trimmed the number of ongoing projects from 467 to 20 following a review. By focusing the right resources on a reduced number of projects the likelihood of positive outcomes is greatly enhanced.

Increasing or adding fees to financial services products would need to be easily justifiable in relation to the cost of actually providing the product or service, as there is increasing scrutiny on fair charges from both regulators and customers.

Therefore, other opportunities to introduce new revenue streams such as data monetisation and partnerships to provide with customers with services they would be prepared to pay for could be an attractive proposition.

In the UK, some banks offer current accounts which have a monthly fee that entitles the customer to 'perks' such as travel insurance, vouchers for retail and hospitality outlets or cashback.

**Strategy and operational models:** there has been a seismic shift in the way that financial services workforces are currently working. Remote working has been possible in most organisations for some people, some of the time but recent events have demonstrated that more roles can be done remotely than previously thought and accelerated the time needed to adapt.

There were initial challenges with connectivity, hardware and people adjusting to the new situation and organisations have been responding and evolving as the situation unfolds. Banks established HR teams specifically to understand the challenges and help their people adjust to working remotely, conscious that it is easier for some than others both practically and psychologically.



As the number of customer queries flowed, there was an 'all hands-on deck' mentality as people were drafted from one part of the organisation to another. As the demand is becoming more manageable, thoughts are turning to how to best use the skills and capacity within the organisation.

Some are creating workforce registers of skills and capabilities to enable quick transfer of people between roles, moving to where the demand is. Banking advisors have been answering customer queries on the phone rather than in person and tellers have been drafted in to help with enquiries through social media.

This is possible during the crisis mode but in the long-term, people may not be as willing to be redeployed.

It has become clear that people would like to retain the ability to work remotely more frequently, even now we are able to return to the offices and branches, leading one global banking CEO to reflect that big offices may be a thing of the past. Any reduction of real estate will necessitate a level of 'hot-desking' and activity-based working to maximise the space available. Hygiene and sanitation will become paramount as staff seek reassurance against potential cross-contamination, ideal in normal times but critical in a pandemic. Buildings will require more cleaning staff and clear, thorough processes, possibly with a visible sign or 'seal' on desks to confirm that the cleaning has been completed.

**Digital:** the current economic crisis has quickly brought a change in customer behaviour and requirements, particularly with regard to uptake of digital transactions and solutions.

Financial services organisations need to remain vigilant as COVID-19 related scams have already been targeting customers through phishing and fraudulent investment offers that relate to COVID-19 products or offer 'safe-haven investments' during turbulent times.

During times of hardship, credit and loan applications will increase where fraudsters will use false information to take advantage of increases volumes. Remote working also opens up more opportunities for circumventing usual procedures and potential internal fraud. Banks need to review their procedures and controls to ensure that they have adequate resourcing of these areas to prevent the unprecedented environment being taken advantage of.

The control models also need to account for the changes in consumer behaviour during lockdown. The strong preference for contactless payment methods has seen a huge decrease in cash usage. People who previously rarely used their credit card may have significantly increased their transactions as they shop online. Businesses that continue to transact in cash may indicate money laundering or tax fraud.

The accepted wisdom pre-COVID-19 was that use of cash is reducing, but figures from the Reserve Bank shows that actually the amount of cash in circulation was up by \$1b at the end of March 2020 compared to March 2019. A large portion of this was a result of demand in the days leading up to the COVID-19 lockdown and the Reserve Bank expects this to return to normal levels as the pandemic eases. With the strong preference for contactless payments at this time and the demonstration of a strong banking system, this 'run on the banks' seems to be over.

Contactless payments have fast become essential for businesses to operate in an environment considered to be safe. In person, this relies on PayWave which previously has a limit of \$80 per transaction. This has been increased to \$200 to enable a larger proportion of sales to be accepted without the need for customers to touch a keypad.

PayWave has previously been seen as prohibitive by many small businesses such as dairies and cafes, however all the major banks have supported these businesses by reducing or waving these fees during the crisis. This pricing model may need to be viewed as part of a wider business support package going forward.



**Elastic workforce:** the rapid adoption of remote working has shifted both the mindset and logistical considerations that has prevented many organisations who were reluctant to embrace flexible ways of working.

This is not unique to the financial services sector, although there are obviously specific considerations to be made concerning compliance requirements.

Financial services organisations have prioritised looking after the health, safety and wellbeing of their workforce. With the boundaries between work and life blurring, the need for empathy and understanding is crucial. While physically more distant from each other during the lockdown period, colleagues found themselves closer together as they were invited in on video calls to each other's homes, meeting children, partners and pets. Bank bosses were doing internal and external video messaging and interviews from sofas and kitchen tables.

This willingness to show vulnerability is reflected in the strong leadership being shown at this time. However, there needs to be a recognition that not everyone is comfortable or in a position to share. The blurring of backgrounds or not turning cameras on in video calls needs to be seen as a valid option.

Productivity is also not a challenge faced only by the financial service sector and they have seen demand spike in some areas while fall away in others. The banks have not needed to adjust remuneration for staff and have continued to pay normal level salaries regardless of whether someone is able to continue their role as productively as they were pre-COVID-19, whether this is connected with childcare challenges or other factors.

Many financial services organisations had technical vacancies that they struggled to fill pre-COVID-19 but now have no access to skilled migrants as the borders are likely to remain closed for some time. Looking at ways to upskill current employees to develop required capabilities is now even more critical, although does not solve the short-term problem.

**Sustainability:** Sustainable lending and investing are critical to the performance of financial services organisations.

With numbers of distressed customers rising, it is important to ensure lending criteria has been reviewed to accommodate the evolving situation. Customer survival and the need to drive the economy have to be balanced with the need to consider responsible lending, and a standard approach may not be appropriate in the current environment. Models and lending algorithms will need to be adjusted to reflect the impact of the new reality while maintaining a long-term horizon view.

With the market volatility impacting returns, members of KiwiSaver have become more aware of their investment. For many, this is their only exposure to the stock market, and they are unused to seeing their investment reduce. Providers should take the opportunity of greater customer engagement to assess their customers financial goals and risk profiles to correctly align their customers with their products.

There has been a move toward more ethical and socially responsible investing in recent times with fund managers such as Blackrock warning companies they will need to demonstrate sustainability through commitments to diversity, inclusion and climate change in order to retain investment funds from them. Several large fund managers provide ethical or sustainability focused portfolios and there is evidence that these funds have outperformed the general market through the volatility caused by COVID-19.

Retail investors are also becoming increasingly aware of the ability to make a difference through their choices and there will continue to be pressure for organisations to be more transparent and phase out investments in companies that are not aligned to these values, or at least offering the option of a fund based on ethical investing.

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