FCA Future Horizons Conference

A banking renaissance – making trust and culture central to 21st century retail banking

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On my first visit to Florence, I sat on a stone bench outside the office of the first-ever bank. There, in the fifteenth century, business had been transacted outside so that everyone could see that deals were being done fairly – and could shout if there were unknown risks on either side. This system supported trust between the bank, its customers and the wider local community.

Moving on to the nineteenth century, some local men met in a pub near Swindon. Each of them needed to buy a house, but none of them could do so on their own. They collectively chipped in for the first house, which was allocated to one of them. They did this again and again until each of them owned a house. The forerunner of the present Nationwide Building Society was formed. Trust between the members was a core element of the mutual model.

Northern Rock grew from similar roots. It helped people in the North East to save in order to finance houses for as many people as possible. It also made a broader contribution to society in the North East. For example, when many borrowers were in the grip of the miners' strike, it forgave them their mortgage payments until the strike was over. Northern Rock and its members trusted each other.

In recent years, various reports have pointed to low trust in banks.[1] This is hardly surprising. Complex and opaque pricing structures make it difficult for customers to trust banks and often lead to poor outcomes for consumers.[2] As well as reducing trust, these pricing structures also inhibit competition.[3]

In addition, there is a perception that banks and bankers are more interested in looking after their own interests than those of their customers. For banks to be trusted, they need to have cultures which lead to good outcomes for consumers and to banks making appropriate contributions to the communities in which they operate.

At Virgin Money, our ambition is to make 'Everyone's Better Off' – a corporate philosophy that we refer to internally as EBO. This is about building win-win relationships between Virgin Money and our customers and other stakeholder groups. It does not mean that customers should benefit at the expense of other stakeholder groups. It means really treating customers fairly rather than just complying with regulations about treating customers fairly.[4]

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[1] See for example UK Financial Services Customer Survey 2016, Accenture, April 2016.

[2] In the core relationship product of personal current accounts, 'free' banking is not free: free banking for some customers, including more affluent customers, is paid for by others - mainly overdraft users, including less affluent customers going into unauthorised overdrafts and paying excessive charges (see Summary of provisional findings report, Retail banking market investigation, CMA, October 2015, paragraphs 51(c), 52 and 53). In deposits, initial bonus rates are designed to take advantage of consumer inertia. New customers often get better deals than loyal customers. In this way, banks play upon the inertia of many of their customers. Consumers must be vigilant to get a good deal and a good outcome.

[3] For example, although Virgin Money aspires to offer full-service personal current accounts, it would be difficult, in the current environment, to compete effectively by offering current accounts with transparent monthly fees rather than 'free' banking (with 'hidden' charges).

[4] EBO underpins the way we go about doing business today, as well as the approach we are taking to creating products and services for the future. For example, we try to ensure that our products are straightforward and easy to understand and that their pricing is simple and clear - and not misleading. We also strive to provide both new and existing customers with good value products.

In this essay, I would like to challenge the widespread assumption that it will take many years to improve the culture of UK retail banks and restore customers' trust in them.[5]

In a more competitive retail financial services market built around new technologies, products will, over time, become more commoditised and price differentials will erode. As a consequence, firms will increasingly compete on the basis of trust and culture. This is because consumers will only embrace new technological developments where they trust the provider – and only those firms with the right culture will inspire such trust.

So I believe that ten years from now, the winners and losers in retail financial services markets will be determined by a mix of technological capabilities and consumer trust – but trust will clearly be the key factor. While new technologies will enable innovative banking services, consumers will prefer to use services in which they have confidence because they trust the provider.

The winners in retail banking will therefore be those firms that are successful in building and maintaining trust – these are likely to be the firms with the most deeply embedded customer-centric cultures.

Current reality: what is happening in retail banking?

Process innovation has transformed many industries over the last few years and this trend is likely to accelerate over time. For example, facial recognition makes passport checks easier and quicker. Similarly, driverless cars, made possible by powerful computers and machine learning techniques, will transform the process of driving cars, and may well transform our lives in ways that we cannot yet imagine.

In retail banking, product and process innovation has been limited. Retail banking products are essentially the same as they were fifty years ago.

In many markets, better processes come through competition and are driven by consumers. However, in retail banking, it seems that pressures for change are not likely to come initially from either consumers, because of their low engagement and trust, or from providers, because of the legacy systems and vested interests of the large banks and the barriers to entry by new banks.

Why are banking processes still cumbersome and difficult when new technologies are transforming other aspects of our lives? Reasons for the lack of process innovation may be attributed to the banks themselves, to the regulators and customers:

[5] The Parliamentary Commission on Banking Standards (PCBS) said that banking "[i]s a long way from being an industry where professional duties to customers, and to the integrity of the profession as a whole, trump an individual's own behavioural incentives" (see Changing banking for good, Parliamentary Commission on Banking Standards, Volume I, paragraph 90). Subsequently, in a report on the culture of British retail banking by New City Agenda and Cass Business School, the over-arching conclusion was that "[i]mproving culture will take a generation"(see A report on the culture of British retail banking, New City Agenda/Cass Business School, November 2014, page 10).

- *Banks:* Large incumbent banks may be slow to develop innovative processes that use new technologies. This is because of the limitations of their legacy systems as well as their (understandable) self-interest in protecting their incumbency advantages by maintaining the status quo.[6]

- *Regulators:* Conduct regulations, however well-intended, have had the effect of discouraging innovation. Banks have found it 'a challenge to interpret existing rules and policies for the use of new technologies or solutions'.[7] They have been particularly concerned that failure to comply with the regulations might make them liable to sanctions at some time in the future, by regulators.[8]

- *Customers:* The CMA, for example, has observed that, because of low levels of engagement, switching levels are low and customers are not driving innovation.[9] However, it seems unreasonable to 'blame' customers: if banking processes were easier and better for customers, they would be more engaged and would demand even better processes from their bank – or switch to another bank offering better processes.

A future scenario where trust is central

Ten years from now, retail banking will be characterised by innovative online and digital banking services based on intelligent systems and often developed by FinTech companies. Providers of these banking services will be able to use digital signatures and information about individual customers accessed through Open APIs.

Using these banking services, it will be much easier for customers to select products that are appropriate for them. It will also be much easier for customers to open accounts, compare and switch between products and manage their financial affairs across a range of products.

Greater competition combined with new technologies will increase the commoditisation of retail banking products and will limit differences in pricing between different providers. At the same time, differentiation will be achieved through the customer experience.

These developments would all be welcome. They have the potential to create an environment in which innovation and competition can flourish for the benefit of customers.

But for this potential to be realised, customers will need to trust their providers and a prerequisite for this will be that firms have the right culture.

New banking services, using flexible technologies and Open APIs, will make this possible – although not inevitable – through a process of customer engagement, education and empowerment, and a modern form of 'shouting':

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[6] Despite the potential for disruptive innovation, the impact of challenger banks has been limited by low levels of switching, particularly in the core relationship product of personal current accounts. This makes is difficult for challenger banks and new entrants considering disruptive innovation to feel confident that they could achieve sufficient volumes to justify the necessary investments.
[7] Feedback Statement on Call for Input: Regulatory barriers to innovation in digital and mobile solutions, FSA FS16/2, March 2016, paragraph 2.25.
[8] Financial Advice Market Review Final report, HM Treasury/FCA, March 2016, section 5.3, pages 54-55.
[9] Provisional findings report, Retail banking market investigation, CMA, October 2015.

- *Engagement:* Smarter consumer communications, including text that is straightforward and easy to understand, videos and illustrations and optional video links to bank staff, should improve customer engagement.

- *Education:* Consistent with smarter communications, interactive services should enable customers to gain a better understanding of financial products and of their benefits and limitations.

- *Empowerment:* Banking services using Open APIs should further improve engagement and education by providing information that is tailored to individual consumers. In addition, innovative services developed by banks and/or FinTech companies should empower consumers, by making it much easier to compare products that are appropriate for them and to switch between products and providers.[10]

- *Shouting:* An important feature of online services for booking hotels and restaurants is reviews submitted by previous customers. They can help potential customers to identify good service providers. Conversely, poor reviews will serve as a powerful discipline on providers. Equivalent features in new banking services will lead to the creation of an online version of the shouting that took place in Florence. The new form of shouting will be even more powerful because online reviews can be read by large numbers of consumers.

However, as noted above, customers will have to believe that they can trust their banks in order to benefit from new innovative online banking services. In particular, for consumers to allow firms to access their personal information, despite concerns about identity fraud, they will want to feel confident that their information is secure and that it will not be misused or passed on to others. Consumers will also need to be confident that they can get redress in the event of fault by their bank or by a supplier of technology services to their bank.

Other critical factors supporting trust in the innovative banking services will include the ease of understanding what providers' offer, the absence of 'hidden' charges or catches, the ease of using banking services and their operational reliability. In addition, many consumers will be more willing to trust new services that have received positive reviews from other users of them – and vice versa.

In this scenario, the cultures of banks and, more specifically, the extent to which they are willing to understand and meet the needs of individual customers will determine how successful they are. Those firms which serve their own interests, or simply comply with regulatory requirements, will be less successful than those with genuinely customer-centric cultures which build trust with their customers.

What could prevent this future scenario from coming to pass?

While I hope this future scenario will also be the future reality, it is by no means inevitable.

[10] For customers to embrace services based on Open APIs, outstanding matters relating to security and redress need to be addressed. Also, digital signatures (or an equivalent solution) are needed to enable customers to overcome practical problems associated with account opening - and, subsequently, with remembering passwords.

In ten years' time, it is possible that retail banking will still look pretty much the same – with the all too familiar competition problems still evident in core markets such as personal current accounts and SME banking and consumers continuing to receive a poor service.

As recognised above, consumers are unlikely to drive innovation and competition as long as their engagement and trust in banks remains low. Also, although innovative processes could increase customer engagement, the large incumbent banks have a vested interest in maintaining the status quo and smaller firms will be discouraged from entering the market if switching remains low and the regulatory environment does not seem supportive.

While I am optimistic that this will not be the case, possible reasons for there to be little transformation in retail banking over this period could include:

- *Consumers not embracing new technologies:* Customers need to be prepared to use these new services. As the saying goes, "You can lead a horse to water, but you can't make it drink". Customers are only likely to be enthusiastic users of innovative banking services if they have confidence and trust in them and in the banks that provide them.

- *Regulation that hinders innovation and the uptake of new technology:* For regulation to support innovation, its application to new technologies will have to be clear. If conduct regulation fails to evolve with technological developments, innovative firms could find themselves constrained by detailed and prescriptive regulations that become outdated. This could have the unintended effects of inhibiting innovation and limiting the extent to which customers can benefit from new technology.

- *Vested interests successfully defending the status quo:* The large incumbent banks could seek to delay innovation in the way that they seemed to delay the launch of Faster Payments. For example, they could seek to influence collaboration in areas such as the development of open API standards, in order to protect the status quo or reduce the extent of threats to it from FinTech companies who could offer innovative banking services that deliver good outcomes for consumers.

Conclusion

There are several important preconditions for building and maintaining a retail banking system based upon customer confidence and trust. Products must be transparent with no hidden pitfalls for customers. It must be easy for customers to switch products and/or banks. Customers must have access to the right advice for their circumstances. Also, lending must be responsible, staff must be well trained and systems must be safe and secure.

But all of these preconditions, even taken together, are insufficient in themselves to create the necessary confidence and trust. The real difference will come from the way in which firms do business, reflecting their sense of purpose, their internal culture and their relationships with their customers and with society as a whole.

The future of retail banking is neither product and process innovation nor new technologies and FinTech. These developments – as important and exciting as they are – will be the catalyst for greater innovation and competition but also, importantly, better cultures in banks and better outcomes for consumers. The future of banking is about banks regaining the confidence and trust of their customers. Those that create organisations, products and services that deliver good outcomes for their customers will the ones that succeed.

The Parliamentary Commission on Banking Standards supported the creation of a professional body in banking but thought it would take at least a generation to do this. I believe the developments outlined above will lead to retail banking developing many of the characteristics of a profession – including building trust, serving the needs of individual customers and operating under standards as well as rules – within a much shorter period.

The bankers of fifteenth century Italy learned early on that trust was the key to their success. It is a lesson that we need to relearn.