additiv

What society needs from the financial sector

Now more than ever before

Everyone's watching the upheavals across financial markets these days. Beyond industry insiders, people from all over the world look at the financial industry for signs of what their future might look like.

The COVID-19 outbreak cut through the web of a global economy, forcing a sudden shift in trajectory. Growth - sometimes at all costs - was the main standard for success for a long time in the financial sector. But that's not what society needs from it now.

authors

MICHAEL STEMMLE
Chief Executive Officer

CHRISTINE SCHMID
Head of Strategy

THE STAKES HAVE CHANGED.

THE FOCUS HAS SHIFTED.

For the financial sector, this is both a test and an opportunity

Undeniably essential

Financials - be it incumbents or new market entrants - are at the heart of the economy and our daily living.

They are the oil that keeps the engine running. This metaphor runs deeper than it may seem, encompassing society at large through its continuous cycle of employment and consumption.

The financial sector provides the essential transfer mechanism for goods, value, and even relationships.

It turns deposits and funding into lending that supports consumption and individual and business development. Financials such as risk capital for VC, PE, and startups fund innovation and future growth.

It's how long term wealth growth can be achieved through professional investment management.

What's more, it provides the processes and instruments to expand corporate growth abroad, through international corporate banking.

But what's been missing for a long time - a process accelerated once the last remnants of the 2008 crisis dissolved - is an honest look at opportunity costs.

A broader pool of options

The financial industry charges for both palpable and often much more abstract services and transactions.

Taking on risk has a price attached to it. This is the role corporate banking and investment banking play. Similarly, so do financial advisory services and transaction mediation ones (IPOs, payments, stock trading, etc.).

Ensuring safety also comes at a cost. Insurance for us and loved ones, peace of mind gained through safe storage of savings, wealth, and safekeeping of assets - this is also part of the financial industry's modus operandi. People all over the world pay to keep their money in the bank, knowing the company will layer capital, liquidity, risk management, compliance, cybersecurity, and other safeguards to ensure a level of stability for their near and distant futures.

Financial institutions also have rates for **granting access** to capital in a wide range of formats.

> *"The expectation nowadays is that people are able to do things quickly and easily, with multiple points of access."*
>
> Rhydian Lewis,
> founder and CEO of RateSetter - The Good Bank

While it has been rather stable for the past decades, **the pricing structure in the financial industry is now under pressure** to change and to adapt to new societal needs. Fast.

Technical innovation and a growing pool of new market entrants that generate rifts in the traditional value chain are driving costs down and increasing transparency.

Financial institutions can - and should - accommodate **an expanded purpose**: serving the society for a return.

The kind of banking the world needs (now and going forward)

We're living at a tipping point.

A lot of things are about to change both in how things work and how we see them.

A world in crisis exposes shortcomings, it washes away expendables, it recalibrates expectations. So here are some that are dissolving right under our eyes, a fact whose consequences change how financials work and how we live.

In her book, "Doughnut Economics", Kate Raworth points out that:

> *"Depicting rational economic man as an isolated individual – unaffected by the choices of others – proved highly convenient for modeling the economy."*

Just as Kate observes, it's blatantly obvious this perspective no longer works. Humans are not fundamentally rational. Instead of pretending they are and forcing behaviors into an outdated definition, we need to build new solutions that accommodate people's entire selves.

So what does the new world of banking look like?

Which principles must it embody and practice to serve a world undergoing deep transformations?

We don't have to look far or start from scratch for them.

In September 2019, 130 banks from 49 countries launched The Principles for Responsible Banking which "*provide the framework for a sustainable banking system, and help the industry to demonstrate how it makes a positive contribution to society.*" Even more, banks have signed since the launch.

The Principles for Responsible Banking

PRINCIPLE 1:
ALIGNMENT

We will align our business strategy to be consistent with and contribute to individuals' needs and society's goals, as expressed in the Sustainable Development Goals, the Paris Climate Agreement and relevant national and regional frameworks.

PRINCIPLE 2:
IMPACT & TARGET SETTING

We will continuously increase our positive impacts while reducing the negative impacts on, and managing the risks to, people and environment resulting from our activities, products and services. To this end, we will set and publish targets where we can have the most significant impacts.

PRINCIPLE 3:
CLIENTS & CUSTOMERS

We will work responsibly with our clients and our customers to encourage sustainable practices and enable economic activities that create shared prosperity for current and future generations.

PRINCIPLE 4:
STAKEHOLDERS

We will proactively and responsibly consult, engage and partner with relevant stakeholders to achieve society's goals.

PRINCIPLE 5:
GOVERNANCE & CULTURE

We will implement our commitment to these Principles through effective governance and a culture of responsible banking.

PRINCIPLE 6:
TRANSPARENCY & ACCOUNTABILITY

We will periodically review our individual and collective implementation of these Principles and be transparent about and accountable for our positive and negative impacts and our contribution to society's goals.

Source: *UNEP Finance Initiative*

So how might implementing these principles look like?

Banking that supports a safe place to live a healthy life

The challenges we face cannot be handled without involvement from the financial sector. The more important and pressing they are, the more obvious this becomes.

Our planet is at risk from global warming caused by dangerous levels of carbon footprint and consumption, societies are pressured by the pandemic of a new virus, and borders rise again at unprecedented speed. To continue to exist - and even improve - our current lifestyle demands **strong Environmental, Social, and Governance actions.**

What the financial sector can do about it:

- provide **investment solutions for all client groups**, including those working to address global warming and other issues with worldwide impact
- **supply the right investments and lending** in companies that lead in ESG actions. These can be low-carbon-footprint organizations that work to protect the environment and whose supply chain and production process are turning to or built on socially and ethically correct work contracts and strictest governance
- **design and issue green bonds, social bonds, and transition bonds** to support the transformation of the global economy.

Solutions to highly ethical issues such as global warming and health insurance affordability require time to be articulated and fine-tuned. **The risk** here is to cut off support too fast and make previous efforts redundant.

Banking focused on building long-term, resilient financial wellbeing

At this moment in history, we're experiencing never-before seen longevity. That's one reason why there's a **growing pension gap** looming which requires additional, different wealth planning not only from government-led sources but increasingly from private savings too.

What the financial sector can do about it:

- Engage in **practical actions to address society's needs for financial literacy**. This also requires simple financial products with transparent, lower pricing, delivered through direct means or digital channels
- Provide **more accessible, performing wealth management** products and services through seamless accumulation and decumulation solutions. To achieve this, there's a need to simplify how the system works and also streamline the cost structure. Wealth aggregation and overview must be at consumers' fingertips.

> *"It is unlikely that banks will earn much from this endeavor in the short term. But the long term is a different matter. A good banking partner can help the poor edge into the middle class. And the ability to offer very low-cost services, often to customers that will never set foot inside of a bank branch, requires an inventive combination of people, process and technology that will have positive spillover effects on other parts of the bank (not to mention society at large)."*

The Good Bank

Banking that lowers wealth inequality and ensures wealth inclusion

In a world threatened by depleting resources and supply chain disruptions, banks can have a big, positive impact on wealth inequality. Without coordinated action involving the financial sector as a key driver, piecemeal solutions are unlikely to lead to meaningful results.

What the financial sector can do about it:

- Design simple, cost-effective direct channels to deliver **micro-lending products** and **accessible wealth inclusion solutions**
- Open up to a larger pool of customers through **transparent, low-cost banking solutions** that start at **low levels of investment.**

This incurs the risk of trying to use the old economic principles instead of architecting new ones which, while imperfect, do a better job at satisfying current and future human needs.

Walking the talk

To design a new economic model that shifts value from economic growth to a definition that works for the people and the planet, **active involvement** from the banks is fundamental.

Change is burgeoning, here and there.

In August 2019, an influential group of 200 CEOs that head some of the biggest companies in the US formalized their view of the future in the Statement on the Purpose of a Corporation. In the new paradigm they propose, each stakeholder is perceived as essential, including the community, the actors in the supply chain, and the customers.

Milton Friedman's doctrine - *"there is one and only one social responsibility of business - to use its resources and engage in activities designed to increase its profits ..."* - is obsolete.

There is plenty of research that's worth deriving insights from and sufficient options to choose from when defining a new financial valuation model. For any progress to happen, though, one element is essential: **trust.**

> *"The point is that when all of the pieces are unbundled, you need an aggregator of trust to stand in the middle. The bank is an aggregator of trust - an aggregator of products and services from a trustworthy source."*
>
> Saurabh Narain, chief executive of the National Community Investment Fund - The Good Bank

To build and maintain trust, banks have to act in the right direction and do it consistently. Walking the talk becomes more important now than ever.

A core driver for resilience and regeneration

Technology and innovation are one of the main enablers for change in both consumers' habits and societal perceptions.

We witnessed their power after the 2008 crisis when combined efforts led both incumbents and newcomers (startups) to offer a range of new products that satisfy specific consumer needs and values.

It bears repeating that this new stage we're entering requires a **relationship-first approach** instead of a product-led one, especially when trying to onboard customers who've never been part of the banking system.

Financial actors committed to embracing this opportunity for difficult and rewarding growth will be able to better leverage technology and innovation to build relationships that last and honor their promises. It all starts with alignment - both internally and between the bank and its community.

Consumers judge actions, not intentions

The road to hell is paved with good intentions. We all know that.

What often happens, though, is that good intentions are tossed aside in times of crisis, the likes of which we're experiencing right now.

There are two major risks that threaten the progress of the kind of work the financial sectors need to do in order to achieve these lofty - but vital - goals.

The increasing lack of return is one of them. At a time when central banks are still struggling with the aftermath of the 2008 financial crisis, they have been pushed into renewed emergency measures - including low or no rates - because they need to support vital parts of society, such as healthcare and businesses.

What's more, for countries whose residents have high fixed incomes through pensions, the pressure is even greater.

Geopolitical tension and volatility is the other major risk. Sadly, the fact that we're reverting from globalization to multipolarity - caused by taxes, fragmentation, and broken long standing economic deals - is a reality.

Counteracting these *me-first* tendencies with constructive action involves that **we all take responsibility for our decisions,** no matter our role or relationship with the financial sector. But one cannot take responsibility for decisions they don't even perceive as such. So the connected issue of financial literacy resurfaces.

In our world and the world future generations will live in, banks can **orchestrate lasting value through systems of networked intelligence**. These systems combine **software**-as-a-service with **integration**-as-a-service, **aggregation**-as-a-service, **service**-as-a-service, and **analytics**-as-service in a way that engineers value not just for single clients but for the network of users as a whole.

When everything is a service, technology and innovation enable banks to adopt a strategy that enables them to act responsibly towards all their stakeholders and support society throughout its regeneration process.

additiv

Established in 1998, additiv partners with the world's leading financial institutions to help them capitalize on digitization. Its market-leading DFS® (Digital Finance Suite) is an orchestration engine that lets financial institutions quickly launch new propositions as well as giving them the intelligence to maximize customer engagement. Headquartered in Zurich, additiv is supported by a broad ecosystem of implementation and solution partners that enable it to deliver unparalleled customer success to wealth managers and credit providers globally.

www.additiv.com

THE MARKET-LEADING SYSTEM OF INTELLIGENCE FOR DIGITAL FINANCE