I am delighted to welcome you to the first edition of the quarterly Willis Financial Institutions Group (FIG) Banking newsletter.

In this first edition, Willis experts look at how banks can protect their most valuable asset - their people. We also look at the potential impact of technology and competition reviews upon the banking sector.

FIG is a new industry group at Willis. It comprises ex-bankers, former regulators and insurance professionals. FIG has been specifically created to connect experience across the Willis Group and to support our clients with the resources they need to respond to changing regulatory pressures and uncertain economic and market conditions. As a risk advisor and as a broker, we work with clients to identify and develop solutions to their risk management problems. FIG will help bring the best of Willis to our clients.

FIG’s client proposition consists of three pillars:

INFORM: Our unique experience enables us to assist in identifying and overcoming key regulatory and commercial challenges.

PROTECT: We create effective and reliable risk mitigation solutions using insurance and non-insurance markets.

GROW: We optimise our client’s commercial position by freeing up capital and growing revenue, thus enabling clients to enhance their own business strategy.

Please contact me or your usual Willis representative if you’d like to share your thoughts and feedback or if you’d like further information about how FIG can work with you.

Thank you for your time and I hope you find this newsletter informative.

Mary O’Connor
“Chase or Google?” my colleague challenged me, asking which would be more important in ten years’ time. The answer may well be neither.

Thanks to technology, many services that were once the exclusive domain of banks can now be offered by much smaller and nimbler firms like Lending Club, Square, and Prosper. Google or Apple may well use their mountains of cash to buy some of these start-ups. Or perhaps banks will see the opportunity and scoop them up instead, as BBVA did with the digital banking platform Simple.

There is, however, another possible—and chaotic—alternative. Web-based newcomers like Uber, AirBNB, and ZipCar have disintermediated the established hospitality and transportation industries in an extremely short period of time. We have not yet seen the killer app that will unseat traditional banks, but it might yet be coming.

**Person-to-Person Payments**

The next big thing in financial services may well be person-to-person payments. Google Wallet is striving to become the leader in electronic commerce, but it has yet to truly capture the public imagination. That leaves plenty of room for disruption from one of the dozens of person-to-person payment systems currently proliferating around the internet, including the wallet app Venmo and Bitcoin startup Circle Financial.

Likewise, peer-to-peer lending is in its nascent stage, but growing quickly. Lending Club’s initial public offering, expected to come later this year, may raise as much as half a billion dollars. The company already boasts a valuation of nearly $4 billion.

These internet-based competitors are no longer pipe dreams, but real institutions with real money behind them.
**The Unnamed Future**

I submit that the future of banking—that collection of services that moves money and investments—may well be dominated by firms whose names are unrecognisable to most Americans at present.

If an app were available tomorrow that allowed me to move money from my account to a friend's securely and simply, I probably wouldn't care if the logo attached to the app belonged to a Fortune 500 company or a relative newcomer. I am certain that my children, who grew up downloading apps and music from any available website, wouldn't care.

These upstarts won't be traditional deposit-taking organisations in need of insurance from the Federal Deposit Insurance Corp. Nor will they seek access to the Federal Reserve discount window or underwriting securities. They will, however, bring with them a whole new set of risks—from greater fraud threats to heightened cybersecurity dangers.

**Risk and Regulation**

Regulators will be hard-pressed to keep up with oversight of these new entrants into the fringes of their world. However, the public has repeatedly shown that they are willing to accept those risks in exchange for convenience. I for one now deposit my cheques by taking a photo with my phone. I pay for my coffee with a QR code on a mobile payment app that allows the coffee shop to debit my account. While both of these services present additional risk, they also make my life a little easier. It's a tradeoff many consumers are willing to make.

**Prevent Disintermediation**

If the future of banking lies beyond traditional banks, what are the established institutions to do? The answer is simple: Don't get left behind. Banks need to find a way to band together to create universal payment systems and broad direct lending alternatives. Otherwise, they risk becoming a part of the old economy.

*This article was originally published in American Banker, July 16, 2014.*
Financial institutions are global organisations operating a worldwide footprint. Banks based in unstable parts of the world should ensure they identify and mitigate potential risks to their people.

Banks frequently operate in less developed parts of the world. They are often the first to open offices in emerging economies, permitting much-needed international investment and promoting local employment. However, as recent events in parts of Eastern Europe and the Middle East have highlighted, there are numerous challenges with operating in unstable or uncertain regions. Consequently, banks must consider and develop their resilience to the risks of operating in emerging and frontier economies.

Given the interconnected nature of global finance and the speed with which events can unfold, it is critical that banks develop a resilient structure that is capable of identifying threats, mitigating risks and responding effectively to a crisis. The core of a financial institutions strategy must include an effective means of identifying, transferring and reducing the threats to the company’s most valuable asset — its people.

Bank employees, local contractors, expatriates and family members operating in an increasingly connected but diverse world can face a variety of potential risks from criminality, violence, civil unrest, political instability or terrorism. In order for banks to develop and implement realistic mitigation measures and formulate a pragmatic crisis management approach, they must first develop an awareness and understanding of the social, political and economic context in which they operate. This will permit an effective management of a bank’s “people risks”.

Criminality, violence and kidnap
Risks ranging from low-level criminality at one end of the scale, to kidnap at the other, can pose a threat in certain regions during key events. For example, in February this year during the run-up to the Winter Olympics in Sochi, there was an increase in crime and a
series of terrorist attacks. Russia’s criminal gangs targeted foreign nationals whilst Islamist militants from the North Caucasus proved themselves capable of successfully organising and carrying out deadly attacks in a number of cities across the country. The run-up to the 2014 World Cup was also fraught with difficulties, highlighting Brazil’s challenging security environment and inadequate infrastructure. Despite significant investment in security measures and the implementation of new police tactics, business travellers, football fans and expatriates faced a myriad of potential issues, ranging from petty theft on the beaches of Copacabana, to kidnapping and violent demonstrations in some parts of the country. For both global sporting events, many banks worked closely with specialist risk advisors to ensure that staff and clients were provided with an understanding of the potential risks and given appropriate advice on how to reduce their individual risk exposures. Advice ranged from how to dress and act appropriately, to taking safe in-country transport and understanding the key threat areas for criminality, political protest and terrorism.

Travel risks
Individuals frequently face travel disruption and delays. Bank employees operating in unstable regions can face heightened travel risks caused by unpredictable events. Recent attacks by the Pakistani Taliban at Karachi’s Jinnah International Airport left hundreds of travellers stranded. The assault resulted in the facility’s closure and the suspension of all flights at Pakistan’s busiest airport. In this case, it was crucial for banks to have the ability to respond effectively by making alternate travel, accommodation and security arrangements for their staff. The incident highlighted the need to mitigate the potential vulnerability of businesspeople and staff travelling through transport hubs in fragile states. In Libya, renewed fighting and clashes at Tripoli International Airport in July following a failed ceasefire between rival groups highlighted the influence militias have on the security landscape. Flights in and out of the airport were diverted and the facility closed. Elsewhere in the capital, increasing violence forced the closure of a number of banks and key government buildings. Banks that had developed special contingency measures in concert with specialist risk advisors were able to identify hold-fast locations and deal with staff and expatriates encountering roadblocks and checkpoints across the capital. Although movement was minimised in the city, banks and risk advisors were able to monitor staff safety and levels of militia violence.

Terrorist threats and political violence
Conferences and international events are at risk of becoming overshadowed by security threats posed by violent groups. For example, The World Economic Forum for Africa held in the Nigerian capital, Abuja, in May 2014 presented the militant group, Boko Haram, with an opportunity to disrupt the forum and take advantage of the increased media coverage. The event was attended by current and former heads of state, senior ministers and financial executives from around the world. Despite increased security levels and the US State Department releasing a warning of a possible terrorist attack in Lagos, many businesspeople attended following in-depth pre-travel briefs, advice on safe locations and regularly revised contingency plans.

Terrorist attacks can also prompt a total withdrawal of staff from a region. In Iraq, tensions between the country’s Sunni, Shia and Kurdish communities worsened, leading to renewed concerns of terrorist attacks. Violent attacks threw the security environment into sharp focus. The speed of the militant advance raised doubts about the Iraqi security forces’ preparedness to deal with the growing insurgency, compounding the risks to businesses operating in Iraq. Organisations working in high-risk zones such as Iraq require regular updates and support from specialist risk advisors to ensure their employees are able to evacuate swiftly and safely into safe areas.

Where extreme violence or terrorism poses a risk, banks are increasingly working with specialist crisis and risk management teams to deal with a variety of potential threats and incidents. Sophisticated crisis and risk management teams will also fit within the structures of a bank’s contingency and crisis prevention plans, ensuring cohesion and avoiding disruption. Together, they can help protect staff and employees and ensure they receive the best possible response in the event of a crisis.

July 2014
This month saw the launch of two further inquiries into banking. At one level, given the history of the sector since the turn of the century, this is not unexpected, but they do serve as a reminder that the focus of the banking regulators remains on the essential structure of the sector as much as the day-to-day conduct within it. The potential for significant change is that much greater.

**Financial Conduct Authority – Wholesale Sector Competition Review**
The FCA has announced its intention of conducting a review of competition in the wholesale sector – defined for these purposes as “wholesale securities and investment markets and related activities such as corporate banking”. It has opened its engagement with the industry by publishing a “call for inputs” – in effect, seeking views from a wide range of stakeholders on where competition is not working effectively. This initiative followed the announcement in June of a joint Treasury and FCA “Fair and Effective Markets Review” to look at behaviours within the sector and the principles that govern operations within it. That review itself is set within the context of the new Senior Managers and Certification Regime for senior bankers.

The FCA has asked for responses by 9 October 2014; any detailed market review is expected to be launched in early 2015. It is surely no coincidence that the FCA’s new enforcement powers under the Competition Act come into force in April 2015.

**Competition and Markets Authority – Competition Inquiry Into Banks**
The new competition authority, the CMA, has recommended a full competition inquiry into high street banks – focusing upon the provision of personal current accounts and small business banking. The announcement follows from a survey of the commercial banking industry, from which the authority concluded that the UK’s four big banks were too dominant, and that this could inhibit competition.
In similar fashion to the FCA’s approach (above), the CMA will hold a consultation over two months, and will announce on 17 September whether the inquiry will go ahead and on what basis. If it does go ahead, it is unlikely to report until after the next general election in May 2015.

**What Are the Implication of These Inquiries?**

It is very tempting to be apocalyptic and predict all manner of dire consequences short of plague and famine. That would be to ignore two key elements:

— The FCA, in particular, has parallel objectives to its competition object. It is required to “protect and enhance the integrity of the UK financial system”. Recommending action at odds with this objective is unlikely. Similarly, the “unintended consequences” of recommendations that resulted in the withdrawal of free banking would have to pass a significant political hurdle.

— The two inquiries are in their consultation phases. We know the scope of the inquiries, but we have limited sense of the areas on which they will decide to focus. Talk of recommendations of a break-up of the “Big Four” are premature – particularly given the entry of such new entrants to the market as Metro Bank, Tesco Bank, Handelsbanken and others.

There are, however, issues around the inquiries that merit serious consideration:

— These inquiries will give initial indications of how the FCA intends to use its enforcement powers under the Competition Act, and how it will operate its concurrent powers in conjunction with the CMA. There is already a Memorandum of Understanding between the two authorities. However, that is necessarily at a high – almost conceptual – level. The acid test will be how the two organisations work together and, perhaps more importantly, the extent to which they operate in isolation or in concert with each other. The scope for confusion where there are multiple regulators is a very clear risk. More than one financial institution operating in the United States, for example, has been “blind-sided” by the actions of individual regulators, who have acted in a way that was not predicted, or who have refused to be bound by negotiations with other regulators. Predictability of regulation is crucial in complex, sophisticated markets.

— Senior management within banks are spending significant amounts of their time dealing with regulatory issues. No one now would challenge the argument that the appropriate place for many of these issues is indeed the boardrooms and management committees of these organisations. However, there comes a point at which the “bandwidth” of the senior executive, and their organisation’s capacity to deal with change and ability to absorb that change, starts to fail. As *The Times* noted, this is the seventh major competition inquiry in 15 years, in addition to the reviews into conduct that are ongoing.4

— The final decision on which areas to focus the inquiries is, naturally, very important. It is to be hoped that the two authorities will avoid an over-simplified analysis of the markets in arriving at their decisions. For example, surveys (the most recent being by *Consumer Intelligence*) have found a marked reluctance amongst consumers to switch current accounts. There may be many reasons for this – including a certain satisfaction that they “do the job”, that the alternatives are too similar, or that there may be complications in the switch itself. Such reasons of themselves are not evidence of a lack of competition. They could be that consumers, consciously or not, have determined that current accounts are effectively utility products and like gas, broadband and electricity, provided they work and are not over-priced, they are content. It would be a mistake for the regulators to conflate the utility aspects of banking with the consumer service elements when looking at the market.

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4. [http://www.thetimes.co.uk/tto/business/columnists/article4151787.ece](http://www.thetimes.co.uk/tto/business/columnists/article4151787.ece)
The financial crisis changed everything. We have lost banks which were considered the bedrock of the financial world, and some financial institutions, which were once the most profitable in the world, have required state intervention and finance to survive.

Regulation is now changing the nature of banking. Banks have been prompted to de-leverage their balance sheets and de-risk their business. This has led to a reduction of lending to once-traditional sectors, such as SMEs, infrastructure and consumers. Banks have restructured and divested themselves from ‘risky’ businesses, such as commodities. These changes are altering banks’ business models with many banks being pressured to focus upon offering ‘plain vanilla’ services. As banks withdraw from certain sectors and services, new players such as asset managers and financial technology companies are entering the market to capitalise on these opportunities, further changing the financial landscape.

Regulation is placing enormous pressure upon bank employees and changing their roles. Senior executives who joined firms as financial innovators are becoming compliance and risk managers. Many are spending their time and resources obtaining expert advice to understand the impact of regulatory changes upon their businesses and customers. They are under significant pressure to ensure that changes are embedded within their organisation and that staff are adequately educated and trained. Some executives even fulfil their duties with the additional pressure of political and media scrutiny. They face enormous demands upon their time and energy and face an increase in personal liability if something happens ‘on their watch’. Regulatory pressures are damaging their wellbeing and we have seen high profile departures — most notably Sir Hector Sants, former head of the Financial Services Authority, who resigned as head of compliance from a major financial institution after being diagnosed with exhaustion and stress.
Regulatory changes have greatly increased the burden upon middle management and line managers, who are often responsible for implementing change throughout an organisation. Managers are making increasingly difficult decisions as they deal with restructuring and redundancies. They are managing their staff through highly uncertain and stressful times. Managerial responsibilities may have increased but remuneration usually has not, due to public and political pressure to limit ‘bankers’ bonuses’ and curtail an excessive pay culture. A recent online poll of Chartered Management Institute (CMI) members — principally CEOs, directors and senior managers - found that 47% responded that employee wellbeing was higher up the corporate agenda compared with five years ago, with 52% stating that employee wellbeing was the responsibility of the chief executive and line managers, not HR.

A bank employee’s workday has also changed in response to regulatory pressures. Staff are frequently attending compliance training, filling forms or completing administrative tasks for audit purposes. They have to fulfil these new duties in addition to their regular jobs, meaning many bank employees are working longer hours than usual, which is placing them under further pressure. Some bank employees are still responding to the fallout caused by the financial misconduct of former employees and are fearful that a minor mistake will trigger a regulatory investigation.

Regulatory changes are altering banking, and this has taken its toll on employees within the regulated sector. Many employees struggle to manage change and uncertainty, and there appears to be a slow stream of departures from the banking sector to non-bank financial institutions or other industries. The Bank Workers Charity, which provides assistance to current and former bank workers and their families, found that one of the key workplace drivers of ill health and reduced productivity was a concern that the job was likely to change in the future. Work pressures will impact non-work pressures — over 60% of bankers reportedly suffer from poor quality of sleep — which in turn impacts work productivity, as concentration and decision-making are affected by lack of sleep.

Significant amounts of continued stress have a detrimental impact upon an employee’s wellbeing. It is also likely that increased levels of stress will lead to some form of sickness and absenteeism. It is reported that 50% of long-term absences in non-manual workers are accounted for by stress, with absenteeism in the UK costing £29 billion a year. In the USA, the total annual costs related to lost productivity due to absenteeism is estimated at $84 billion per annum.

Banks and other companies are increasingly seeking specialist risk advice to minimise the impact to staff wellbeing from regulatory changes and other pressures. This can cause a spectrum of issues, including high rates of sickness absence, high incidence of litigation and claims costs, and ‘presenteeism’ (employees present at work but with low productivity).

Some employers are proactively meeting the leadership challenge of identifying stress and burnout in employees before these conditions manifest as sickness absence. In conjunction with risk advisors, employers can deploy targeted measures to improve nutrition, health, lifestyle, claims defensibility training and leadership priorities, all of which offer affordable outcomes that help protect and monitor staff wellbeing.

With many economies and banks still recovering from the financial crisis and responding to regulatory change, the challenge for employers to find, retain and protect talent is increasing. Banks and firms that are able to adopt a proactive approach to these issues are protecting and promoting wellbeing, and enhancing the resilience of their greatest asset — their people.

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1 “Bank on your People- The state of wellbeing and productivity”, Bank Workers Charity, page 10.
2 “Bank on your People- The state of wellbeing and productivity”, Bank Workers Charity, page 10.
The FCA came into effect on 1 April 2013 and one of its very first acts was to release a 70-page paper entitled “Applying behavioural economics at the FCA”. Behavioural economics suggests consumers are not rational, logical market participants but are subject to behavioural biases which influence their preferences, beliefs and decision-making. Biases can lead to misjudgement and inconsistency. This can cause individuals to make mistakes when selecting financial products, even though they are in possession of disclosed information that should enable them to make good and informed choices.

The FCA has highlighted examples of biases upon consumer purchases. Firstly, an individual’s preferences may be moved by emotional factors. A consumer may seek to avoid regret by purchasing a type of insurance they do not need, or they may borrow excessively to purchase products without considering their ability to repay the loan.

Biases can affect an individual’s beliefs. Consumers are often overconfident in their own decision-making ability which can affect purchasing and investment decisions, and can cause clients to fail to properly assess risk. Consumers will recall an investment loss more than an investment gain, placing undue emphasis on the former, which may dictate their reaction to future losses, including the length of time they hold a loss-making position.

Biases can also affect a consumer’s decision-making. Consumers might adopt a rule of thumb for decision-making, picking the most familiar option of a product, or basing a decision on whether they trust the sales advisor. Consumer decision-making can also be affected by the way information is disclosed or framed.

The paper also examined the impact of bias upon competition. For example, behavioural economic research shows that consumers do not tend to change their existing products
such as current accounts. Firms might exploit this consumer bias by charging higher fees or by not improving the product — knowing they will not lose consumers or market share. Firms might also take advantage by framing their promotional material to appeal to consumer biases.

The FCA wants to use behavioural economics to better understand consumers and the impact of biases upon competition. Upon the paper’s release, Martin Wheatley stated:

“We want the regulatory system to use behavioural economics to ascertain whether people are being put off switching products through inertia, inattention or even the simple fear of regret from making a wrong decision.”

Since the paper’s release, the FCA has been relatively silent about providing guidance on behavioural economics and how it applies to firms. It has though recently released a study examining how the sale of insurance add-ons affected consumer decisions. The study was the FCA’s first experience of using experimental methods to investigate consumer behaviour.

The FCA’s study demonstrated that the structure of the transaction affected consumers. For example, greater complexity of comparing offers from different providers led to a deterioration in consumer decision-making – consumers were less able to identify the best deal and lost money. The study also showed that lower transparency, due to add-ons being revealed only at the point of sale, significantly exacerbated poor consumer outcomes. Also, the presentation of pricing information had the potential for an adverse effect on consumer behaviour.

The FCA recently launched a review of competition in the wholesale sector, whilst the Competition and Markets Authority recommended an inquiry into competition on the high street. Although behavioural economics was not expressly mentioned by the FCA, it is very likely that the FCA will give behavioural economics greater prominence this year and especially next year, after it receives enforcement powers under the Competition Act, from 1 April 2015. Behavioural economics will play an important role as the FCA meets its statutory objective to “promote effective competition”.

Although behavioural economics can sound daunting, firms may want to use it as an opportunity to better understand their clients. If firms are able to understand consumer biases, they may be better able to understand and meet their clients’ needs. This is likely to improve the overall relationship between the client and the firm, and show the regulator that the firm is putting the client at the heart of its business.

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# Financial Institutions Group

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