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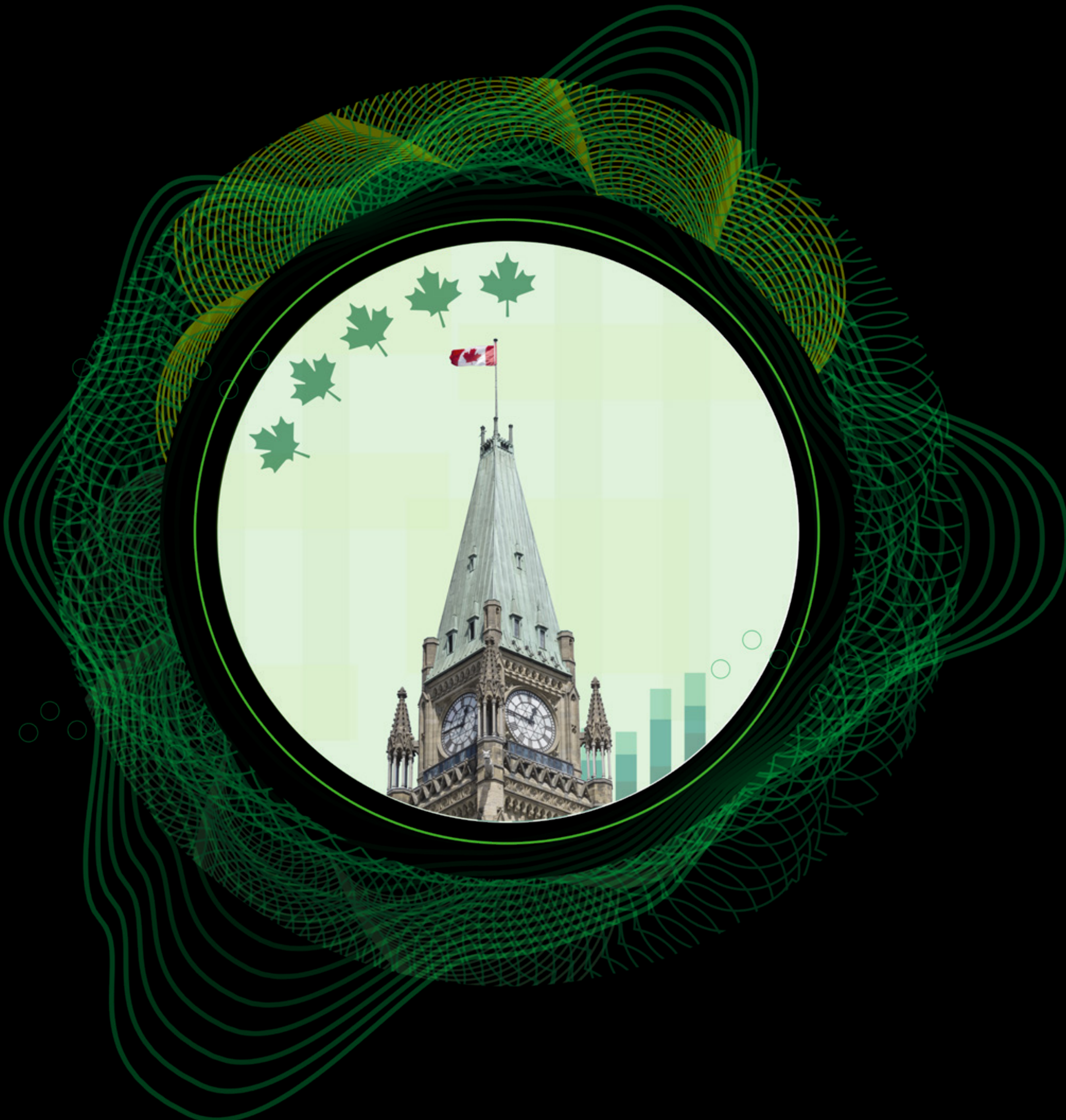

The future of financial Crowns

Evolving business models in financial Crowns

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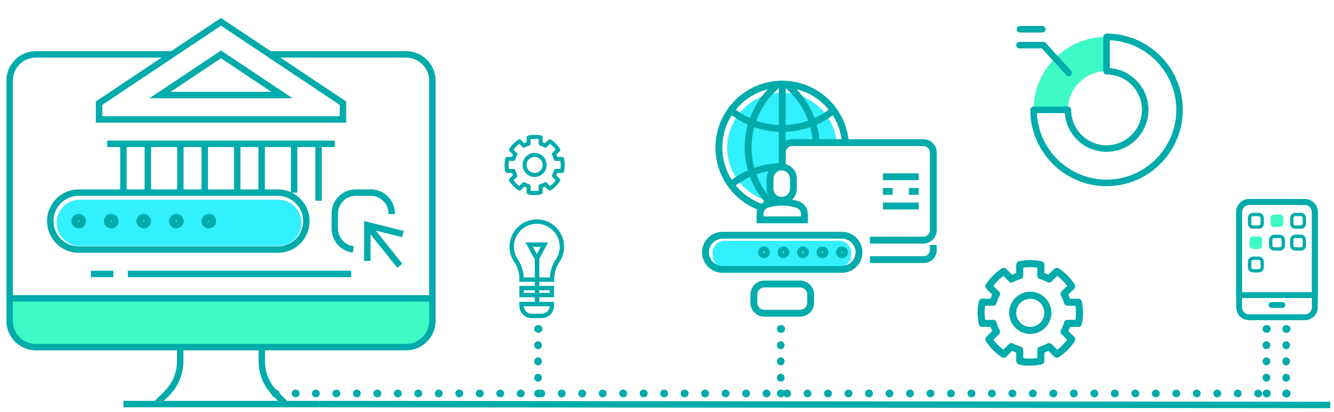
Introduction

"This global pandemic and economic crisis has impacted every home. People's life savings are being affected. Young people are just as worried about their future as those nearing retirement. And thousands of entrepreneurs, many who have put decades into their businesses, are worried about surviving the weeks and months ahead... In times like these, people remember who was there for them."[1]

Dave McKay, president and CEO of Royal Bank of Canada.

Rising unemployment rates have pushed financial insecurity to an all-time high, along with increased fears of price-gouging and the inability to pay rent. These uncertain economic times prove that public-sector entities play a crucial role in the Canadian economy, despite not receiving as much attention as their private-sector counterparts. For example, Export Development Canada (EDC) and Business Development Bank of Canada (BDC) were the vehicle of choice for the Government of Canada to offer emergency aid through the Business Credit Availability Program (BCAP) and the Highly Affected Sectors Credit Availability Program (HASCAP), while the Canada Mortgage and Housing Corporation (CMHC) was to chosen to provide the rental assistance needed for many businesses to survive.[2]

As Crown corporations dedicated to financial services, financial Crowns are an integral part of Canadian society, often assuming risks and providing services not fulfilled by the private sector. Pandemic or not, they exert significant influence over the economy. Take the Bank of Canada's role in controlling interest rates, the function of Canada Deposit Insurance Corporation (CDIC) as a backstop for Canadians' deposits, or the Canada Pension Plan Investment Board (CPP Investments) managing CPP fund assets on behalf of 20 million Canadians.



The landscape of Financial Crowns

Several categories of financial Crowns provide targeted market-complementing services across five categories:

Lending organizations—help support businesses and organizations in specific sectors, segments, and jurisdictions (e.g., EDC, BDC[3])

Investment funds—oversee management of pension funds, sovereign funds, and other asset-management entities (e.g., CPP Investments, Caisse de dépôt et placement du Québec (CDPQ))

Regulators and the central bank—set and execute financial, fiscal and monetary policy relevant to the financial services (FS) sector or provide pertinent supplementary help (e.g., Office of the Superintendent of Financial Institutions (OSFI))

Insurance carriers—provide public insurance and related services (e.g., CDIC, Insurance Corporation of British Columbia (ICBC))

Real estate and infrastructure organizations—help ensure the effective operation of the sector, in addition to managing real estate and infrastructure investments (e.g., Canada Infrastructure Bank, Canada Lands Company, CMHC)

In recent years, the broader FS sector has been incorporating sweeping new technologies and adjusting to changing consumer needs. However, financial Crowns have seemed to lag, whether in adopting emerging technologies such as artificial intelligence (AI), preparing the talent pool for the Future of Work, developing novel business models to meet Canadians' changing needs and expectations, or adapting to a new regulatory environment. As they rushed to support the Canadian economy through the COVID-19 crisis, this gap widened even more. Nevertheless, they'll need to reinvent themselves to continue to be relevant to Canadians and Canadian businesses beyond the pandemic.

"Lockdown restrictions have not impacted all businesses in the same way. Just as workers and Canadians are living different realities in this pandemic, so too are our various sectors. Businesses are getting back on their feet at different rates, which is why the next government must not approach recovery as a black and white scenario."

Alla Drigola Birk, Canadian Chamber of Commerce, Directory of Parliamentary Affairs and SME Policy[4]

Challenges in an evolving landscape

The Canadian Chamber of Commerce estimates that small and medium businesses in the hardest hit sectors will continue to need government support through 2022.[4] The ability to marshal resources swiftly to address those needs could make or break the effectiveness of a government intervention. Now more than ever, financial Crowns must look for ways to integrate emerging technologies to transform their operations. This was made evident with the Canada Emergency Response Benefit (CERB) program, with the federal government having had to make the difficult choice to forgo extensive oversight to speed up the financial-aid response[5] and resort to cheques as one of the main modes of disbursement. By contrast, digitally advanced governments abroad were better prepared. Estonia, for one, managed to keep 99% of its established, digitally-enabled government services accessible online, including those involving identity confirmation.[6]

Like all financial institutions, financial Crowns are facing mounting pressure to adapt to changing market trends. But unlike their private-sector counterparts, they must navigate a more complex environment to do so while meeting a broader mandate. For example, their unique structure means that any initiatives that use emerging technologies or an innovative business model must meet domestic and international standards that often go beyond financial services regulations (e.g., human rights standards, or the World Trade Organization's policies).

As the country's path forward gains further clarity from the economic uncertainties exacerbated by the pandemic, several key questions have emerged for financial Crowns:

1. Why should they embrace new trends and provide new customer-experience models?
2. How will they navigate emerging challenges as they adapt to changing citizen and business needs?
3. What capabilities must they have to successfully change their delivery models?

Considering the future of financial Crowns

Based on Deloitte research, the experiences of our federal financial services team—which has been working closely over the years with financial Crowns—and secondary research, we've identified four trends. Each report in this series focuses on one of these trends, exploring their impact on financial Crowns and the related challenges these organizations face in a changing economy.

Distinct implementation hurdles and key benefits are associated with each of these transformations. But perhaps more importantly, each one offers financial Crowns opportunities to refresh their business models by modifying their operations and reframing ongoing interactions between leadership, talent, and customers.

In each report, we'll explore the four trends to better understand:

1. Their impact on financial Crowns and how this may differ from their effect on financial institutions in the private sector

2. Best practices and current approaches taken by financial Crowns in adopting these trends

3. Potential capabilities that financial Crowns should consider implementing

Evolving business models

In contrast to many private players, financial Crowns have a neutral position as ecosystem builders and are often the sole providers of specific services in the Canadian economy. As new customer preferences and business models emerge in FS—including fintech services that wouldn't have been possible a decade ago—financial Crowns should assess their current offerings, deciding if they should evolve and, if so, how.

Future of work

The changing nature of jobs is broadening the types of talent available to FS organizations, while a tight labour market is widening the spectrum of engagement models (e.g., gig economy, crowdsourcing, contractor use). For financial Crowns to adjust to the Future of Work, they'll need to appeal to a dynamic younger generation, adopt new work-delivery models and prepare existing workers through new training methods.

Future of digital

Business models in FS are built on predicting and balancing risk. This may happen during engagements such as customer acquisitions, loan origination, or investment decisions.
New technologies continue to bring fundamental changes to the ways these actions are performed. While a survey showed that 86% of financial institutions believed that AI will be very or critically important to their business's success in the next two years,[7] not all organizations are equipped to handle this innovation. Indeed, 60% believe that risks associated with using AI-based models are slowing their adoption of AI technologies.[8] To integrate a suite of AI tools, financial Crowns will have to look beyond implementing point solutions and instead focus on adapting to new possibilities that come from operational excellence, enhanced mandate delivery, and effective risk management.

Future of policy and regulation

New regulations are emerging in response to novel and highly specialized FS players, putting pressure on established organizations to reinvent business models and engage in new partnerships. For these directives to be successful, innovation must be encouraged while still protecting the public from unintended consequences. Digital technologies should also be used to increase operational efficiency and improve customer service.

Evolving business models in financial Crowns

"If there has been one silver lining in all the tragedy and sacrifices of the current crisis, it has been the spirit of collaboration and unity of purpose that has been evident between levels of government, across provinces, and across sectors."

Rocco Rossi, president and CEO of the Ontario Chamber of Commerce.[9]

The pandemic has placed mounting pressure on Canadian financial services to support Canada's economy, citizens, and businesses as they weather the storm. Because of heightened financial insecurity nationwide, even risk-averse incumbent financial institutions are realizing they can no longer win by doing business as usual. Those who control the lion's share of the market also have the added responsibility of the customer, whose expectations across the board are rising. A real market demand exists for customer proximity.

In recent years, Deloitte and the World Economic Forum have explored how citizens now expect access to financial support. New platform models now exist that address these emerging needs and preferences.[10] With customers increasingly seeking one-stop shops and easy access to financial services, these platform models are becoming more common. Extending this trend, financial institutions will have to either own stand-alone digital platforms or distribute their products through others' platforms.

On a tactical front, we've made two observations. Firstly, financial institutions are making noteworthy shifts toward their value-added activities. Secondly, they're redirecting personnel to project work as opposed to day-to-day operations.

It's also interesting to note that more organizations in the industry are including corporate social responsibility practices at their core, using them as differentiators in the market as opposed to just checking boxes.

Why do these observations matter to financial bodies created decades ago, in economic contexts radically different from those of today? Compared with the private sector and given their somewhat monopolistic position historically, some Crowns have had less incentive to rapidly deploy new offerings. However, the pandemic has shown that financial Crowns have the required infrastructure and relationships in the marketplace to do so. This realization should be an invitation to financial Crowns to re-examine the role of innovation in their organization, and re-think their business models.

For financial Crowns to meet public expectations and continue to support the backbone of the Canadian economy, they'll need to make their business models more flexible. They must reorientate toward a fast-to-market, innovation-first approach. One that involves building social capital, adopting platform models, refocusing on customer-centric core capabilities, and doubling down on innovation.

"Transition to net-zero is creating the greatest commercial opportunity of our age."

Mark Carney, former Bank of Canada and Bank of England Governor[11]

Building social capital

How can a financial Crown help Canada shift toward a more sustainable and inclusive economy? How should it begin adopting more environmental, social and governance (ESG) policies and diversity, equity, inclusion and accessibility (DEIA) principles?

Recognizing the impact of climate change, many financial Crowns have been taking the proactive first steps of incorporating green financing into their portfolios. This has been through cleantech investments, increased scrutiny and due diligence on customers and their supply chains, and, in some cases, an outright halt to new business coming from certain sectors. While the latter may align with a broader government agenda, it does pose a dilemma to organizations intended to support all Canadian businesses. We believe there are ways financial Crowns can create win-win outcomes.

Consider an example from the Hong Kong and Shanghai Banking Corporation (HSBC), who have released a suite of financial solutions from sustainability linked loans to green deposits to aid 1.5 million clients around the world find a way to make the transition towards net zero emissions.[12] This suite of products signifies a shift in mentality where financial institutions are looking to engage companies in high-carbon sectors to incentivize the road to net-zero, as opposed to pure divestments.[13]

To grow and sustain their social capital, financial Crowns must consider questions such as:

- How do we develop products geared toward ESG and DEIA that incentivize companies across a variety of sectors to change their operating practices within the boundaries of our risk appetite?
- How do we adapt our internal governance to drive accountability and responsibility for ESG throughout the organization?
- Should we consider partnering with external organizations to augment our offerings and capabilities?

Moving to a platform model

From this team's experience working with Canada's leading financial Crowns, very few have the discipline to dissect performance across the dimensions of products, channels, and customers. Tensions between those dimensions are often at the crux of innovation in private sector financial institutions. How can financial Crowns begin exploring new ways to serve market needs more effectively?

Financial institutions are turning to digital platforms to meet customer demand for one-stop shopping of multiple services and products. Efficiency requirements make product differentiation even more important for institutions, as products must stand on their own without the boost of loss leaders. Financial Crowns must consider whether to operate their own platforms or distribute their services through existing ones. The latter may give them an advantage for two reasons: (1) they get to meet customers where they are, and (2) their direct association with the federal government allows them to cater to both market participants and consumers without conflicts of interest.

For example, the Association of British Insurers—a trade association—has launched a pensions dashboard that aggregates information from insurers and asset managers. This allows customers to view and directly manage all their savings and funds.[14]

Successful adoption of a platform model would require financial Crowns to ask the following questions:

- Are we a natural owner of a platform or should we be participating with other providers to provide streamlined access to end users and consumers?
- Are our customers' needs complex or evolving frequently to require support from a suite of products and services (i.e., new and existing)?
- Is the supply market fragmented? Are there agents, private or public, who are natural owners of the full customer journeys of many market participants —whether customers or suppliers?
- If not, do we have the licence for a suitable platform or are we natural owners of one?

Shifting the focus back to the center

Some financial Crowns may have an array of offerings targeted at specific market segments and require tailored back-office support. But what should leaders be thinking about, as the organization looks for ways to better serve key clients while keeping operational costs low?

Considering the evidence that automation alone brings limited benefits, financial institutions have been exploring how existing technology pilots can create further opportunities for cost reduction. As a result, they're opening up to new types of alliances that enable them to collaborate with industry players such as fintechs. They're even willing to work with their own competitors to realize benefits that no player could achieve alone. This practice is becoming increasingly common. Major Dutch banks ABN Amro, ING, and Rabobank have done this, teaming up to launch a pilot project to share Know-Your-Customer data and prevent money laundering.[15]

Another interesting lever is that of indirect distribution, wherein a financial Crown can use a partner financial institution's sales force and existing customer relationships. The COVID-19 crisis has highlighted the limited operational reach of government agencies when trying to quickly disburse funds to business owners. Contrast this with the reach of financial institutions, who directly own the relationships with the affected end consumers.

An indirect distribution strategy through intermediaries would create tangible benefits for all parties involved, enabling financial Crowns to reach a broader set of business owners. Financial institutions could also distribute complementary product and end customers would gain access to better financing conditions.

A recent real-world example of indirect distribution involves EDC's BCAP. This was built on a risk-sharing agreement between EDC and Canadian financial institutions to provide emergency liquidity to businesses navigating the pandemic. The product was fully underwritten and distributed by partner financial institutions.

If they're to successfully recentre their priorities on core capabilities that add value, financial Crowns must reflect on the key assumptions of their business models. Some questions to consider include:

- Which lines of business are critical to our unique value proposition, and which could be more efficiently provided through partnerships with other institutions?
- How should we revisit our risk-management principles as we enter more partnerships?
- How can we identify partners who understand customers better than we do, to codevelop products and test proof-of-concepts?
- How do we enable partner sales and market adoption in the context of an indirect distribution model?

Financial institutions have been exploring how existing technology pilots can create further opportunities for cost reduction.

Doubling down on innovation

Financial Crowns that have successfully launched cost-reduction initiatives ahead of an economic downturn must balance the maintenance of these projects with modernizing enterprise functions and developing new innovative offerings.

As cost-reduction initiatives continue, employees at financial institutions are now in a rare position to focus on activities that allow them to innovate to improve current offerings or develop new ones. The fast-paced nature of the pandemic response has provided financial Crowns with further incentive to begin shifting resources from operations to project-based initiatives. As a result, they now have an opportunity to deploy formal innovation processes that can help their teams create value. Dutch financial-services cooperative Rabobank, for one, has successfully followed these principles with their annual campaign to identify the most radical technological ideas from employees around the world. This initiative, launched in 2015, rewards contest winners with three-month opportunities to develop their successful proposals.[16]

Financial Crowns that expect to thrive as innovators must consider questions such as:

- How do we balance different types of innovation (core, adjacent, and transformative) across the innovation ambition matrix?
- How do we help ensure our initiatives are generating value and are aligned to our strategic plan, instead of chasing the latest trend?
- How do we create a project-intake process that balances conscientious budgeting with the fast-tracking of potentially fruitful ideas?
- How do we identify and develop talent at various levels so that people can successfully work in an agile or project-based environment?

Conclusion: Balancing customer centricity and financial recovery

As the pace of innovation accelerates—whether in terms of configuration, offering, or experience—the industry is merging traditional financial services with the wealth of opportunities brought about by new technology. For financial Crowns to remain relevant in a world of digital platforms, focusing on core capabilities and effective innovation, they will need develop their capabilities more proactively. These may include:

Building highly reactive innovation functions
They may need to become as active as their private-sector counterparts in deploying functions that scan the market for new ideas. They also need to develop processes and offerings meant for widespread, practical use.

Using the various types of innovation and managing the innovation portfolio
With differentiation becoming critical, financial Crowns will need to shift product development toward human-centred designs. This move will bolster their value propositions not only through product improvement but also through the ten types of innovation.[17] This will help build a competitive advantage while maintaining the balance of incremental—rather than transformational—innovation projects.

Experimenting with the various models of product development
Taking inspiration from the innovative actions of mutual insurers and cooperatives, who do this with less access to capital markets, financial Crowns should explore innovative approaches that transcend their systems. Examples of this could include investment in promising fintech to foster future partnerships and prepare acquisitions, or open innovation, like crowdsourcing, that would maximize their chances of generating breakthroughs. This will either create value for the organization or result in lessons learned for future iterations.

Glossary of terms

1. AI: Artificial Intelligence
2. BCAP: Business Credit Availability Program
3. BDC: Business Development Bank of Canada
4. CDIC: Canada Deposit Insurance Corporation
5. CDPQ: Caisse de dépôt et placement du Québec
6. CERB: Canada Emergency Response Benefit
7. CPP Investments: Canada Pension Plan Investment Board
8. CMHC: Canada Mortgage and Housing Corporation
9. DEIA: Diversity, Equity, Inclusion and Accessibility
10. EDC: Export Development Canada
11. ESG: Environmental, Social and Governance
12. FSI: Financial Services & Insurance
13. FS: Financial Services
14. HASCAP: Highly Affected Sectors Credit Availability Program
15. HSBC: The Hong Kong and Shanghai Banking Corporation
16. ICBC: Insurance Corporation of British Columbia
17. OSFI: Office of the Superintendent of Financial Institutions
18. SME: Small and Medium-Sized Enterprises

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