Financial Institutions Sentiment Survey 2021

Insights and expectations from across the sector

By the side of business

LLOYDS BANK

Welcome

Welcome

Adrian Walkling
Managing Director, Head of Financial Services,
Lloyds Bank Commercial Banking

This is our sixth annual Financial Institutions Sentiment Survey, which collects the latest views of more than 100 senior decision-makers at UK banks, wealth and asset managers, insurers, financial sponsors and intermediaries.

Our collective activities as an industry are driven by our purpose to help people grow their savings and wealth, protect their health, life and property and lend for their major life purchases like homes and cars. A robust and well-functioning financial services sector has to be at the core of any growing economy and inclusive society.

The importance of this purpose has magnified as we emerge from the worst global economic crisis since the Great Depression[1].

There's no doubt that financial services firms have proved incredibly resilient to the impacts of the coronavirus crisis compared to other sectors of the economy.

Between March and April 2020, UK GDP was down by 20%, with construction down 40% and hospitality down 90%[2].

By contrast, financial and insurance activities contracted by a comparatively modest 5%[3], and business volumes have since rebounded rapidly.

Certain subsectors, such as retail share dealers, even had record years thanks to an upturn in 'armchair traders' looking to invest unspent cash. But the wider sector's strong performance wasn't just by chance.

> It's critical that we play our part in the transition to a low carbon green economy that will support the UK's recovery."

Adrian Walkling,
Managing Director,
Head of Financial Services,
Lloyds Bank Commercial Banking

Our sector's role in the recovery

The industry has gone through significant reforms since the 2008 financial crisis and showed great foresight in investing heavily in digital, and consequently was well prepared to pivot to new ways of working with minimal disruption.

The global pandemic will have lasting social and economic effects and the financial services sector has a key role to play in helping Britain recover.

It's also critical that we play our part in the transition to a low carbon green economy that will support the UK's recovery and promote long-term prosperity, while helping to make our planet more resilient. It's heartening to see this important societal work reflected in the responses to this year's survey.

After a year unlike any other, the sector has moved decisively to further its technological capabilities, mitigate risks and secure new opportunities in new markets.

While the coming year will undoubtedly present new challenges, UK firms have the talent and tenacity to overcome these obstacles, keep on innovating and achieve great things.

[1] https://www.imf.org/external/pubs/ft/ar/2020/eng/spotlight/covid-19/

[2] https://researchbriefings.files.parliament.uk/documents/CBP-9111/CBP-9111.pdf

[3] https://www.ons.gov.uk/economy/grossdomesticproductgdp/articles/coronavirusandtheimpactonoutputintheukeconomy/april2020

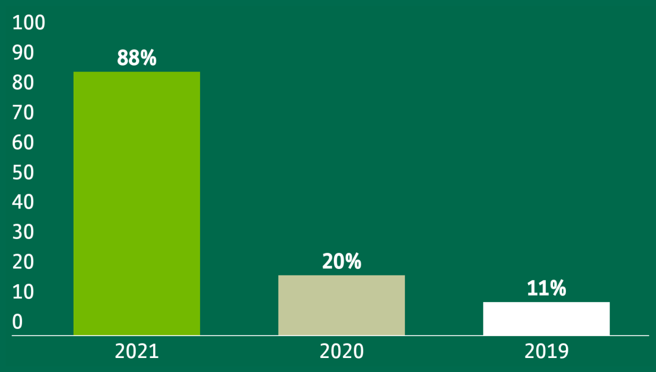
Results at a glance

Results at a glance

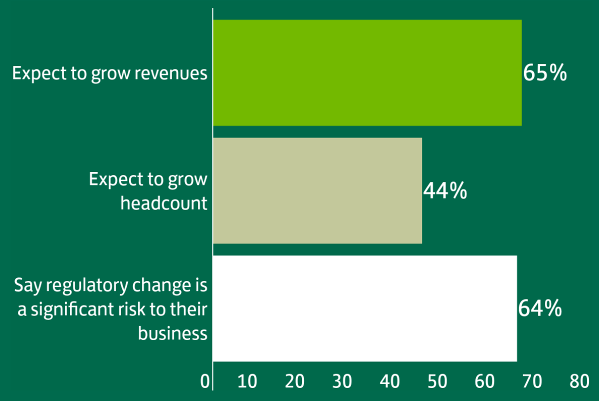
A summary of key insights and expectations for 2021 and beyond from senior decision-makers in the UK financial services sector:

The economy

Expect growth to improve

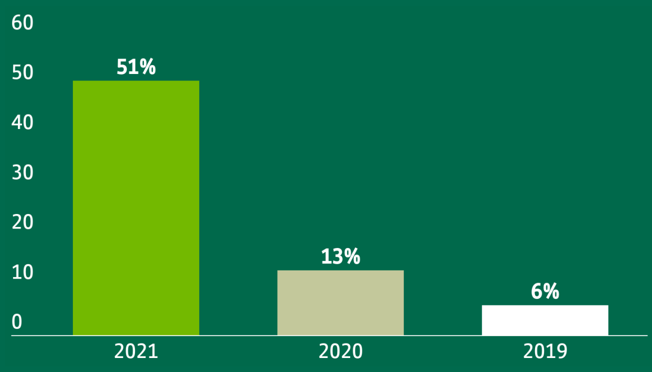


The year ahead



Financial services sector

Expect sector growth to improve



Strategic priorities

77%

say technology, automation and digital investment is a top strategic priority

Technology

71%

are investing in technology to improve the client experience

Sustainability

43%

plan to make their sustainability goals more ambitious in the next year

Economic outlook

Economic outlook

With the threat from coronavirus seemingly receding, thanks in no small part to the success of the UK's vaccination programme, it's encouraging – though not surprising – to see positive sentiment spreading through the sector.

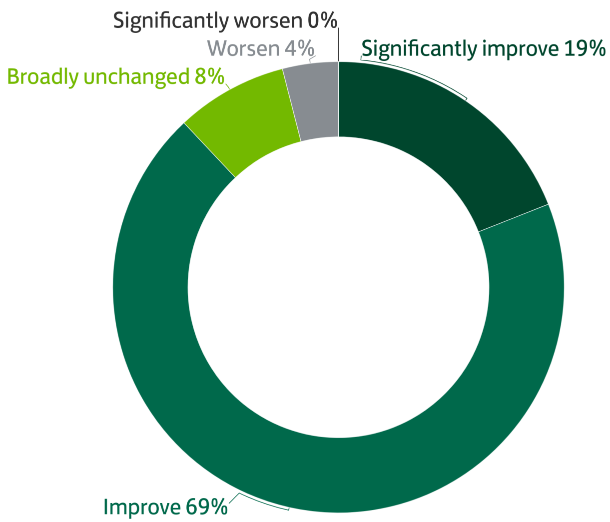
Almost nine in 10 (88%) expect UK economic growth to improve over the next year, compared to just one in five last year and one in 10 in 2019.

As businesses continue to ramp up to full capacity, workers return and pent-up demand is released, this confidence will help drive the ongoing recovery.

Their bullishness is reflected in the latest available Bank of England forecast, which predicts growth of 7.25% in 2021, dipping slightly to 6% in 2022[4].

As expected, three quarters (73%) are more optimistic about the UK economy's outlook than they were a year ago, up from 1 in 20 (5%), though insurers are more bearish, with only 59% having grown more optimistic, potentially because they still expect to be hit with further claims related to the pandemic.

What is your expectation for growth in the UK economy over the next 12 months?



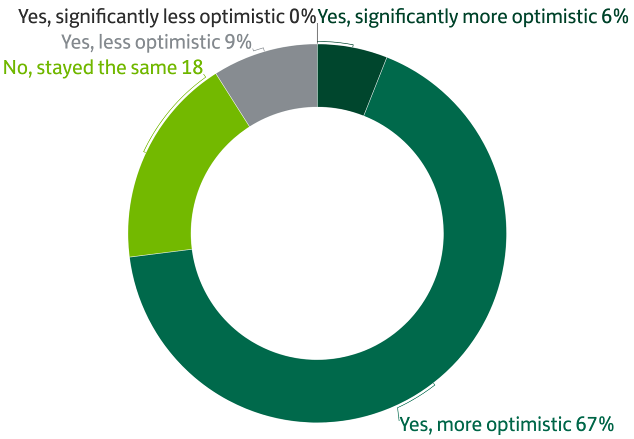
But this overall enthusiasm should be tempered by the findings of the July 2021 Lloyds Bank UK Recovery Tracker, which surveys 14 business sectors and revealed a drop in overall business optimism, driven by concerns over inflation, constrained capacity and access to skilled workers.

This only serves to reinforce how financial institutions were relatively better prepared for the shock of the pandemic than most other sectors of the economy, due at least partly to the robust regulatory reforms since 2008.

Looking at the global context, on balance, slightly more respondents believe economic growth will be stronger in the UK (32%) than in other G7 countries (25%), though the biggest group (43%) believe growth will be broadly similar.

88% expect growth in the UK economy to improve over the next 12 months

Over the last 12 months, has your outlook for the UK economy changed?



The number of respondents who believe the UK will outperform the G7 is up five-fold on last year, reflecting how the UK was hit harder by the virus than many other countries and its subsequent reopening and vaccination rollout success.

The July 2021 International Monetary Fund World Economic Outlook, has the UK neck and neck with the United States, leading the advanced economies with 7% growth forecasts[5].

Spotlight on COVID-19

For context, this research was conducted in June and July 2021, as COVID-19 restrictions slowly started easing.

Respondents said their perceived risk from the pandemic had halved year-on-year, being cited as a top five threat by 34%, down from 62% a year earlier.

While almost half (46%) say COVID-19 boosted their investment in core technology systems, the same proportion (45%) said it had little impact, potentially indicating many firms were already well prepared to operate in the conditions the pandemic created.

It seems the size of firms' investment may have remained consistent, though the focus temporarily shifted from developing new and improving existing products and services to supporting existing processes.

"The sector believes there is real momentum behind the economic recovery, which is instilling confidence to focus on opportunities to drive long-term growth."

Jeavon Lolay, Head of Economics & Market Insight, Lloyds Bank Commercial Banking

And of those that did increase their tech investment in response to COVID-19, enabling home working was the focus for fully 71% - a significant proportion in a sector that has not previously fully embraced flexible working.

[4] https://www.bankofengland.co.uk/monetary-policy-report/2021/august-2021

[5] https://www.imf.org/en/Publications/WEO/Issues/2021/07/27/world-economic-outlook-update-july-2021

The year ahead for financial services

The year ahead for financial services

Britain's financial services sector stands at an inflection point, with significant change ahead in terms of the UK's international relationships, the regulatory environment – including relating to sustainability – and firms' IT architecture.

With so many factors in play, not least the ongoing coronavirus crisis, it's reassuring to see optimism enjoy a substantial rebound.

However, while half (51%) believe growth in the sector will improve in the next year, up from just 13% last year, this figure would likely have been higher, were it not for the sector's robust performance through the pandemic.

In November 2020, for example, just 2% of financial services employee jobs were on furlough, compared to 13% across the wider economy[6].

Not only was the sector able to quickly pivot to more flexible ways of working, many colleagues were classified as key workers, providing essential daily financial services to consumers ensuring the continued functioning of markets and supporting the economy's ability to withstand COVID-19 shockwaves.

And while 41% of firms have become more optimistic about the sector's growth prospects in the last year, the highest proportion (43%) say their outlook hasn't changed.

Evolving expectations

Sentiment around business prospects has also rebounded strongly.

Twice as many firms (65%) now expect their UK revenues to increase than decrease in 2020, which is also higher than the 41% forecasting growth before the pandemic in 2019. However, as in 2020, close to a third (29%) of businesses still expect no material change.

Delving deeper, insurers appear far more bullish, with 76% expecting to grow revenues, compared to 56% of banks, while 100% of wealth and asset managers expect to maintain or grow revenues.

"Respondents' renewed optimism is balanced with a healthy dose of caution. Businesses need certainty on the future operating and regulatory environment to plan for the longer term with confidence."

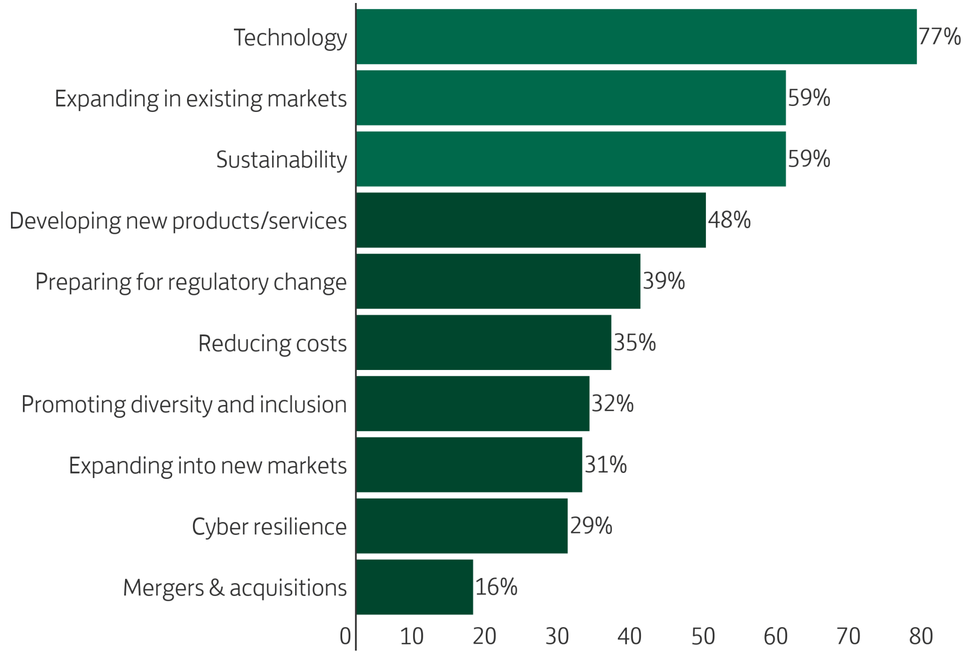
Cynthia Barnes, Managing Director, Head of Strategic Initiatives & Development, Financial Services, Lloyds Bank Commercial Banking

Banks' outlook likely represents their continued caution over the pace at which the economy will recover and associated knock-on effects.

Expectations over return on equity continue to improve, rising to 35% from 21% last year and 19% in 2019, in part reflecting the opportunities to grow margins presented by Open Banking, which will benefit both banks and non-bank financial institutions through fee income and product distribution.

Just over half (53%) of respondents will increase investment in their business, up from 31% for the last two years. At the same time, concerns over inflation and rising labour costs contributed to almost half (47%) of all firms expecting their operating costs to increase, up from 20% last year.

Top 10 strategic priorities for the next year



Given the transformational change to working practices and how many firms have announced plans to reduce their property footprint, any saving here will help mitigate against rising operational costs elsewhere.

But the pandemic's long-term impact on working patterns remains unclear and London was already experiencing a shortage of office space before the pandemic, which has helped support rents that are still second only to Hong Kong globally[7].

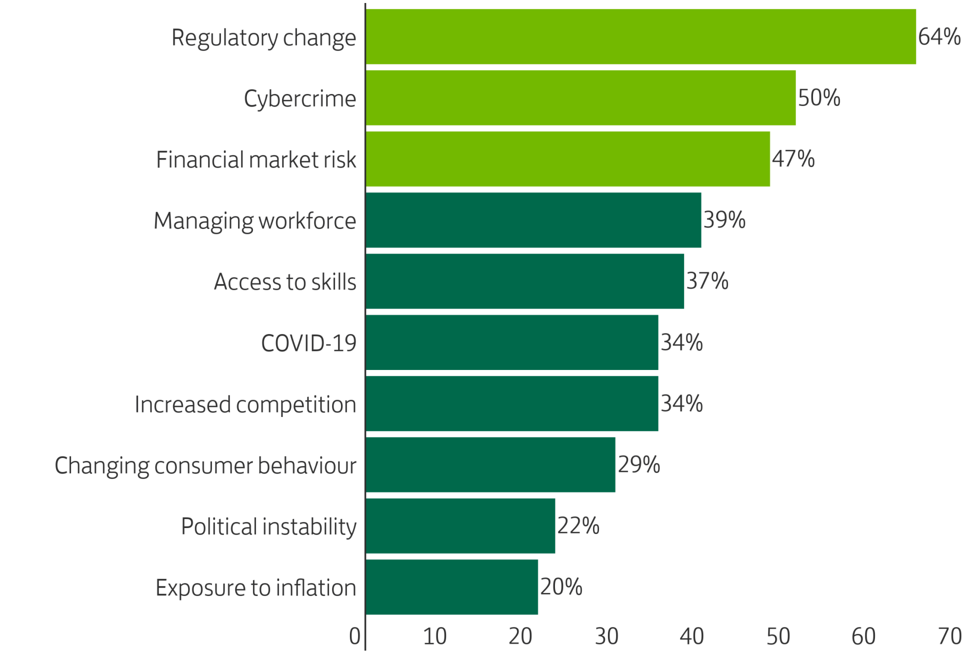
Risk and reward

Looking at firms' strategic priorities, it's no surprise that tech comes top for another year, including automation and digital investment.

With the Brexit transition period now over, twice as many are prioritising expansion into new markets (up from 15% to 31%), while only a third as many are now divesting core assets (down from 14% to 4%), likely because the activity for this cycle has now been completed.

Firms' priorities balance a focus on their existing strengths and a shift towards lower risk strategies, like expanding in existing markets, with more entrepreneurial activity, such as developing new products and services.

Top 10 most significant risks in the next year



Turning to risk, regulatory change is seen as the biggest threat (up from 46% to 64%), which is consistent with the ongoing uncertainty over EU/UK equivalency and the shape of regulatory reform many months after the end of the Brexit transition period.

Spotlight on skills

On skills, we can be encouraged by the finding that almost three times more firms plan to recruit compared to last year (44% vs 14%).

44% will grow their headcount in the next year

This is the same proportion of firms that last year said they had delayed or cancelled recruitment as a response to COVID-19, likely reflecting strong pent-up demand for technology, sustainability and specialist financial market skills.

While half (50%) of insurers plan to create new jobs in the next year, that falls to just a quarter (26%) of banks.

During April 2021, job vacancies in the sector were at their highest levels since before the pandemic and almost three times higher than in the same month last year[8].

Yet a third (37%) flagged a lack of access to skills as a risk, something which could mean more firms targeting other sectors in their search for talent.

[6] https://researchbriefings.files.parliament.uk/documents/SN06193/SN06193.pdf

[7] https://workplaceinsight.net/london-remains-second-most-expensive-office-market/

[8] https://www2.staffingindustry.com/eng/Editorial/Daily-News/UK-Financial-services-job-vacancies-at-highest-level-since-before-pandemic-57940

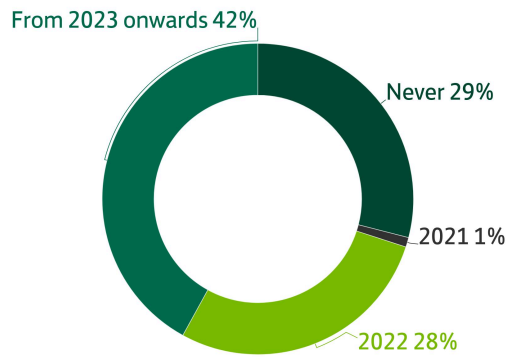
Global competitiveness

Global competitiveness

The UK, and London in particular, has always held a well-earned position as a global centre of trade and finance.

More than two thirds (69%) of those we surveyed agreed that, with the UK's transition period after its exit from the European Union having ended, London will remain one of the world's leading financial services hubs, rising to three quarters for the wealth & asset managers with this sentiment.

When do you expect a UK/EU equivalence deal for financial services to be agreed?



Brexit has affected that status: in January, Amsterdam temporarily overtook London as Europe's largest share trading centre, while assets worth almost £1.3 trillion have been moved to the continent[9].

While the full impact of Brexit on the sector is still evolving, it's fair to say that early fears of a massive wave of jobs and businesses relocating to Europe has not materialised.

Though half (52%) of all respondents think the competitiveness of the UK financial sector will remain broadly unchanged in the next year, more believe it will improve (32%) than worsen (17%).

It seems sensible to conclude that, while London's status has taken a knock due to Brexit, it will remain one of the world's leading financial centres.

To this end, in July chancellor Rishi Sunak declared that the Government would enact a sweeping set of reforms designed to sharpen the UK's competitive advantage in financial services.

These reforms appear to be instead of the Government's original plans to secure a comprehensive financial services equivalence deal with the EU.

Equivalence optimism

Our survey was conducted shortly after this announcement, yet 71% of those questioned still believe a UK/EU equivalence deal for financial services will be agreed, with 42% forecasting this won't happen until 2023 at the earliest. Nearly half (46%) think a deal is important to their business.

Still, close to a third (29%) believe it will never happen.

While 54% of banks said a deal was very important or essential, that fell to 39% of insurers.

That said, there is potentially an opportunity to achieve a competitive advantage by deepening relationships with markets such as China, India and Brazil.

69% agree that London will retain its status as one of the world's leading financial services hubs now that the UK's transition period from the EU has ended.

Accordingly, the number of firms prioritising expansion into new markets doubled.

Firms' top three export markets are currently North America (48%), the EU (32%) and Central/South America, Asia (excluding China) and Australasia (all 29%).

Looking ahead, respondents believe the strongest growth is expected from Asia (excluding China), North America and, perhaps surprisingly, Africa, while demand is expected to fall in the Middle East, the EU and China, where growth forecasts have been revised downwards amid lingering concerns around the virus[10].

Divergence not dilution

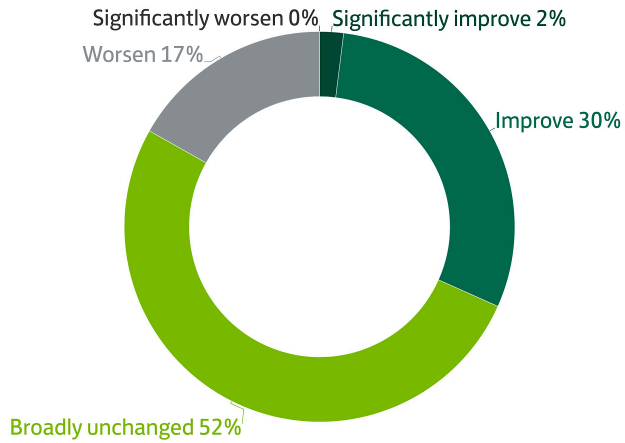
Those we surveyed are split over the potential impact of regulatory change.

Some 48% of those who think UK competitiveness will improve cited regulation that diverges from EU standards and less restrictive regulation as key reasons. Yet among those who think UK competitiveness will worsen, 78% cited UK regulation diverging from the EU.

It's important to emphasise here that regulatory divergence doesn't necessarily mean dilution.

Indeed, there is an opportunity for more green regulation that could give the UK a leading role in promoting the global climate change agenda, particularly in the year that the UK hosts the COP26 conference.

Over the next 12 months how do you expect the competitiveness of the UK financial services sector to change?*



[9] https://www.personneltoday.com/hr/brexit-steady-flow-of-finance-jobs-to-eu-continues/

[10] https://www.bloomberg.com/news/articles/2021-08-09/goldman-lowers-china-growth-forecast-on-delta-virus-outbreak

*Due to rounding, some percentage totals may not correspond with the sum of the individual figures.

Technology

“

A key opportunity for the sector must be to effectively leverage the wealth of data that Open Banking provides to inform and transform the customer experience for the better.”

Steve Everett, Managing Director, Head of Payments and Receivables, Client Products, Lloyds Bank Commercial Banking

Technology

We’ve seen how the financial services sector’s past focus on digitisation positioned it favourably when the pandemic hit, enabling it to transition to remote working almost seamlessly.

It comes as little surprise, therefore, that technology, automation and digital investment remains a top strategic priority for another year, cited by 77% of respondents.

Four in five (80%) expect to grow investment in their tech systems and core platforms, with the aim of improving client experience (71%), driving growth (60%) and boosting productivity (59%).

Their top tech investment priorities are the cloud (83%), APIs (77%) and data science, including machine learning and artificial intelligence (69%).

The cloud and the client experience

The cloud was also the top priority last year, reflecting its importance to digital transformation/transformation from legacy systems and multi-year investments.

Migrating products and systems to the cloud will continue to help providers innovate, respond to customers’ ever-changing needs and reduce the cost to serve.

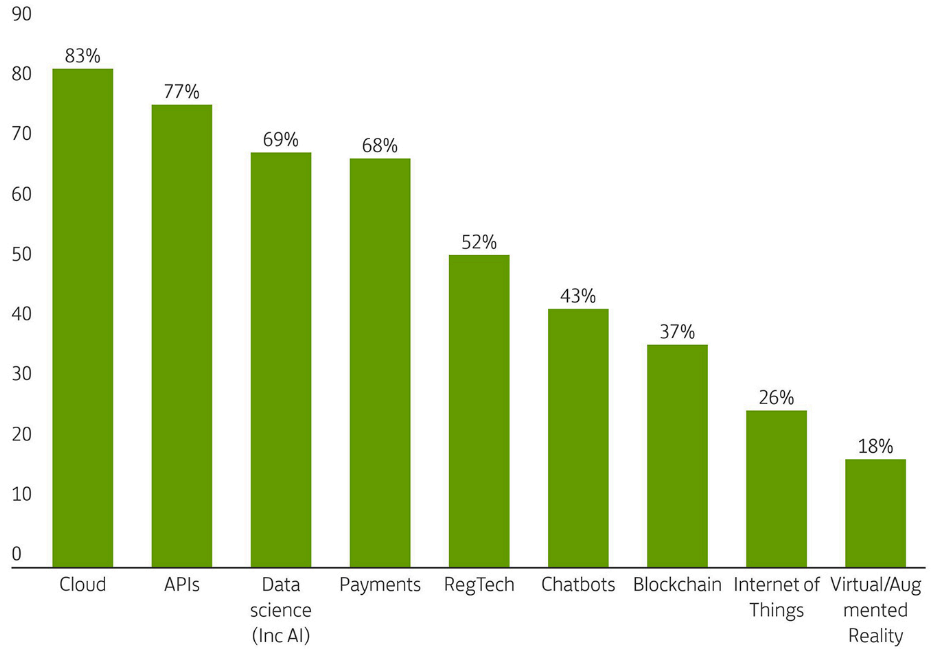
Moving from manual handoff and face-to-face interaction to digital channels results in a better experience for clients and colleagues, while also supporting growth and improved productivity as resources can be pivoted towards other focuses for the business.

For example, since the first quarter of 2020, the number of Open Banking payments has increased by an average of 365% every quarter, creating a faster and more secure experience for consumers and providers[11].

At Lloyds Bank, we continue to meet this demand and opportunity through the roll out of the Lloyds Bank Gem cash management and API platform.

It’s also notable that the number of firms prioritising investment in blockchain has bounced back somewhat, from 27% to 37%. This is an innovative area with great potential that has yet to reach maturity and we therefore expect to see investment continue to increase.

How do you see your firm prioritising investments in the following technologies in the future?



Staying cybersafe

One side effect of the shift to the cloud is that firms have become inherently more vulnerable to cyberattacks, with colleagues forced to work outside secure office networks. Indeed, research by BAE Systems Applied Intelligence found three-quarters (74%) of banks and insurers saw a rise in cybercrime during the pandemic[12].

It is perhaps surprising, then, that while growing numbers flag cybercrime as a significant risk in this year's survey – up from 38% to 50% year-on-year – fewer firms hold cyber resilience as a strategic priority (down from 34% to 29%).

This comes after analysis of almost £750 million of insurance claims by the financial sector shows cyber incidents, including crime, are the top cause of loss[13].

It seems likely that the speed of change demanded by the crisis meant other issues leapfrogged cyber resilience. Yet 70% of financial services companies reportedly suffered cyberattacks during 2020 and there is no doubt cybercriminals will continue to target the sector, given the wealth of valuable data it holds[14].

One way that larger banks and institutions are seeking to mitigate risk is through the adoption of multi-cloud strategies, thus reducing their reliance on any one provider.

FinTech for the future

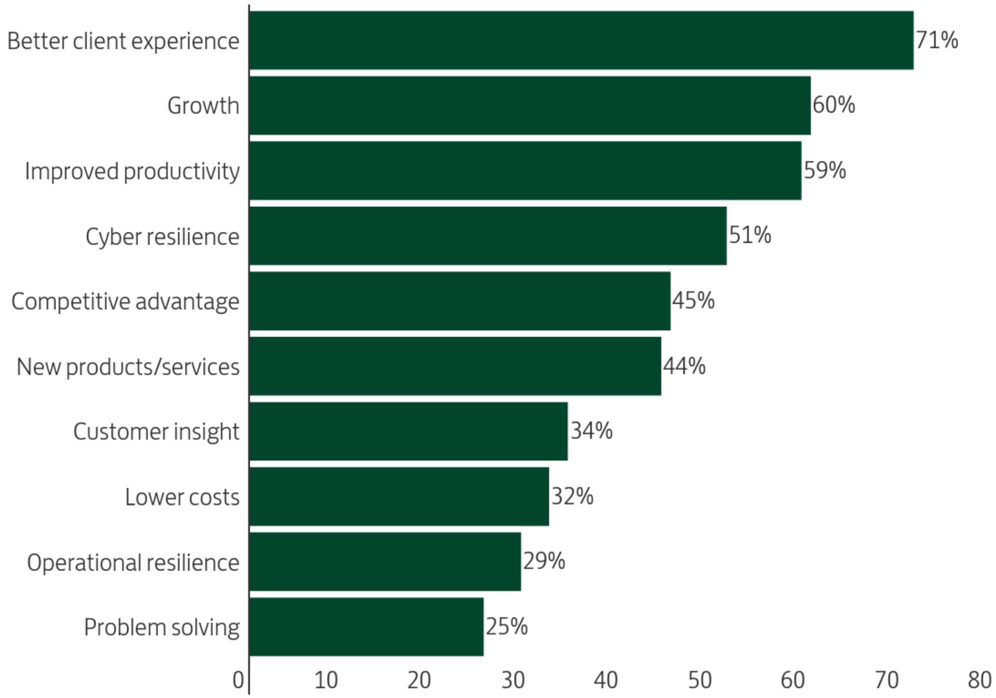
The UK can rightly be proud of its position as a global FinTech leader.

UK FinTech firms won venture capital investments totalling £4.1 billion in just the first half of 2021, smashing the previous record of £3.3 billion for the whole of 2019[15].

46% will grow investment in their FinTech capability through acquisition and partnering

In the next year, 46% of the firms we spoke with said they will grow investment in their FinTech capability through acquisition and partnering. Such investment is designed to develop new products and services (66%), improve client experience (53%) and drive growth (49%).

You said you expect your business' technology investment to increase. What do you expect will be the main benefits?



The continued focus on partnering with FinTechs is a positive, with businesses still clearly committed to finding new solutions to meet changing client needs through collaboration.

There are numerous British FinTechs that have built compelling propositions that are ready to launch to market. The function of developing new products and services continues to shift to a partner model, which can provide a much quicker route to market than developing in-house.

This approach was embodied in our Group's acquisition of investment and retirement platform business Embark during 2021.

[11] https://thefintechtimes.com/uk-open-banking-adoption-is-on-the-rise-according-to-new-yapily-research/

[12] https://www.baesystems.com/en-uk/article/covid-cyber-crime--74--of-financial-institutions-experience-significant-spike-in-threats-linked-to-covid-19

[13] https://www.theguardian.com/business/2021/jul/20/uk-fintech-sector-hits-multi-billion-pound-peak-of-investor-interest

[14] https://www.teiss.co.uk/uk-financial-sector-firms-cyber-attacks/

[15] https://www.theguardian.com/business/2021/jul/20/uk-fintech-sector-hits-multi-billion-pound-peak-of-investor-interest

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Sustainability

Sustainability

The next decade will prove crucial in the global fight to protect the planet for generations to come and the financial services sector has a critical role to play in helping to finance a sustainable future.

It's estimated that low-carbon financing will need to increase five-fold by 2030 to £50 billion a year[16] if the UK is to achieve net zero by 2050, with investment deployed across every sector and region of the economy.

To that end, April saw the launch of the United Nations Net-Zero Banking Alliance, which brought together 43 banks from around the world – including Lloyds Banking Group – to support the global economy's transition to net-zero emissions.

We're playing our part to help tackle climate change and have provided more than £2.3 billion of green finance through a range of real estate, renewable energy facilities and green bond facilitation.

We have seen the 'build back better' narrative that has emerged in the wake of the pandemic can help hasten the transition: green bond issuances by governments and businesses are set to almost double year-on-year in 2021[17].

"The UK has a real opportunity to play a leading role in the funding of new green technologies around the world, so it's really encouraging to see firms working to realise this potential, while striving to make their own operations greener for the benefit of society."

Jonas Persson, Head of Sustainability and ESG Finance, Lloyds Bank Commercial Banking

At the same time, green and sustainability-linked finance represents one of the fastest-growing segments for UK banks, expanding by an estimated 80% a year[18].

Reflecting that, our research found that climate change and sustainability are rising up boardroom agendas, cited as a top five strategic priority by 59% of respondents, up from 33% last year.

In addition, 43% said they plan to make their sustainability goals more ambitious this year, which likely reflects plans to deliver on Environmental, Social and Governance (ESG) commitments they'd already made but may have had to side-line during the pandemic.

Strategies and skills

The main drivers to increase environmental sustainability or sustainable finance are reputation and brand advocacy (71%), management focus (67%) and regulation (60%).

The strong management focus reflects how firms are integrating sustainability into their long-term strategies as a result of expected regulation, strong customer advocacy and an acknowledgement of their environmental and social responsibilities.

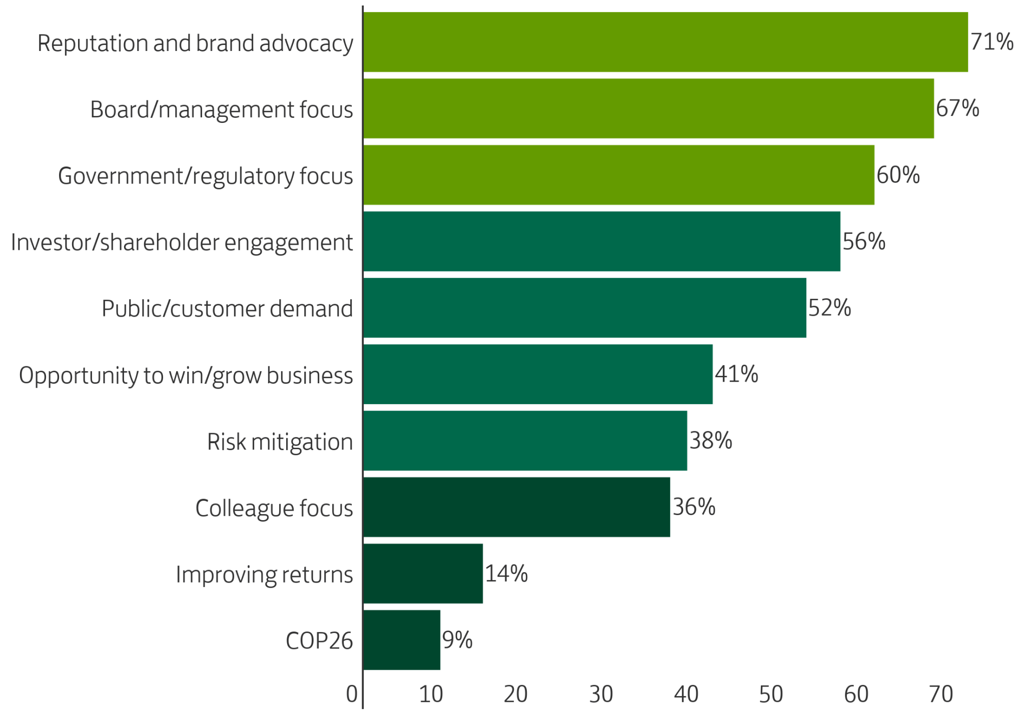
When we asked how institutions' sustainable activities had changed in the past year, there was a net increase in every category.

The biggest uplift was in governance around environmental sustainability (69%), followed by management of climate-related risk (61%) and offering sustainability-focused products and services (60%).

This focus on governance comes as no surprise, given the abundance and complexity of the requirements that are emerging from regulators.

Firms flagged the main challenges to growing their sustainable finance assets as evolving regulation (85%), skills (80% – unchanged on last year) and the availability of products and services/reporting and monitoring performance (75%).

What is driving your business to become more sustainable?



While this underlines the fast pace of change in the regulatory environment, it also highlights an opportunity for the industry to address the current skills deficit, both through in-house training and by working with industry bodies and the education sector to create a pipeline of people with the kind of ESG skills needed.

COP26: Sustainability in the spotlight

A global stage such as COP26 has the power to sharpen focus on the issue further.

> 59% say climate change and sustainability are a top five strategic priority

Indeed, many consider that the leading position that Paris currently holds in the sustainable finance sector can be attributed to the city hosting the previous COP conference in 2015, where 190 countries ratified the Paris Agreement, considered a landmark international treaty addressing climate change.

Today, France is home to sustainable funds worth almost £120 billion, which is close to 40% more than those based in the UK[19].

Currently, the businesses we surveyed were evenly split over the impact of COP26 on their sustainability strategies, with almost half (49%) saying the event had increased their focus, while practically the same proportion (51%) said it had no impact.

How has your level of activity changed in the following environmental sustainability and sustainable finance areas over the last 12 months?*

	Decrease	Unchanged	Increase
Governance	2%	30%	69%
Risk management	3%	36%	61%
Offering products/services	2%	39%	60%
Operational footprint management	1%	40%	59%
Investing in/originating assets	3%	43%	54%

However, we can expect that the UK government will provide an increasingly detailed roadmap to delivering net zero, capitalising on the global platform COP26 provides and setting the direction for more countries and businesses to follow.

[16] https://www.ft.com/partnercontent/lloyds-bank/the-net-gains-of-net-zero.html

[17] https://www.institutionalassetmanager.co.uk/2021/01/26/294959/green-bond-issuance-track-almost-double-2021-market-estimates-suggest

[18] https://www.ft.com/partnercontent/lloyds-bank/sustainability-linked-loans-are-in-everyones-interest.html

[19] https://fortune.com/2021/07/03/paris-brexit-london-capital-green-banking/

*Due to rounding, some percentage totals may not correspond with the sum of the individual figures.

Closing statement

Closing Statement

Adrian Walkling
Managing Director,
Head of Financial Services,
Lloyds Bank Commercial Banking

"I have no doubt that our financial services firms will continue to adapt and remain at the forefront of Britain's recovery."

While the coronavirus pandemic continued to cast a shadow over 2021, we can now dare to imagine that the worst is behind us.

During the crisis, we issued £13 billion of lending to more than 350,000 businesses through government-backed schemes, helped 1.8m people learn new digital skills and shared practical advice to help businesses manage the elevated cyber threat.

Looking forward more broadly, financial services firms' focus on their own sustainability and technology is reshaping the sector for a future where more services will be delivered digitally and with due regard to their environmental and social impact.

This change is being driven from within, and also reflects the changing priorities and demands of our clients.

Indeed, the financial services sector also has a vital role to play in helping our clients to futureproof their businesses by investing in the latest technologies and helping accelerate the transition to a green economy.

In the year that the UK hosts the COP26 United Nations Climate Change Conference, we're expanding the funding available under our green finance initiatives from £3 billion to £5 billion, to help businesses' transition to net zero.

Reflected in the findings of our survey, I have no doubt that our financial services firms will continue to adapt and remain at the forefront of Britain's recovery and, in turn, continue to drive progress on digitisation and sustainability through our role as one of the world's leading financial centres.

Feedback

Feedback

How did you hear about this report?

- Social platform
- Lloyds Bank contact
- Lloyds Bank website
- National or local press
- Email communication
- Other

Send answer

How valuable was the report in helping your thinking and decision making?

- High
- Moderate
- Low

Send answer

Will you talk to your Lloyds Bank contact about some of the themes and insights covered in this report?

- Yes
- No
- Don't have a Lloyds Bank contact

Send answer

To what extent does this study change your perception of Lloyds Bank as an expert in the issues and trends impacting the financial services industry?

- More positive
- No change
- More negative

Send answer

Methodology

To gather representative data, financial decision makers at a cross section of 111 UK financial institutions were surveyed between 15 June and 19 July 2021.

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Please contact us if you would like this information in an alternative format such as Braille, large print or audio.

Important legal information