UK COMMISSION FOR EMPLOYMENT AND SKILLS

Strategic Skills Needs in the Financial Services Sector

A report for the National Strategic Skills Audit for England 2010

Executive Summary 15
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Analysis › Understanding › Insight › Expert advice

Introduction

The aim of this study is to provide an assessment of the skills needs in the financial services sector to 2020 in support of the National Strategic Skills Audit for England 2010, undertaken by the UK Commission for Employment and Skills. This report presents the findings of the assessment which, while discussed in further detail below, are that:

- Between 1998 and 2007 industry output doubled, but employment increased by only 2.2 per cent. Since then total employment in financial services is estimated to have declined between 5 per cent and 10 per cent;

- In the coming decade all the drivers of change, such as increasing levels of regulation, the need for efficiency, consumer demand and globalisation are pointing downwards. In our view, overall employment is unlikely to return to 2007 levels in the next decade and could remain significantly lower;

- Historically there have been certain skills gaps and shortages in particular in retail banking, and in retail and wholesale insurance. While some of these gaps and shortages may persist, others such as risk management and compliance skills and actuaries will come to the fore;

- Regulation could limit the freedom of banks to innovate. This could result in polarised banking business models, with some banks focusing on core retail banking services, generating lower but more stable returns, while other niche providers serve clients willing to take greater risks;

- Efficiency will be paramount in retail financial services as companies look towards recovery and the need to restore margins and profitability. There will be continuing job losses due to branch closures and moves towards more efficient distribution channels, and;

- As emerging economies become more important, client-facing front-office functions in wholesale markets will need to be established close to international clients. As emerging economies grow in importance and develop their infrastructure, further middle-office activities may follow.

The impetus for the Audit came from the policy document, “New Industry, New Jobs”, published by the then Department for Business, Enterprise and Regulatory Reform in April 2009.

“New Industry, New Jobs” identified professional and financial services as one of six priority sectors for development as together they comprise a strong and important sector in the UK economy and there is a need to secure the country’s position as a leading centre of global finance given the current economic crisis. Given the importance of this sector to the economy, this report provides a timely response to the current debate into the UK’s strategic skills needs.

Our study is part of a wider exercise designed to contribute towards the UK Commission's overall response to strategic skills, the National Strategic Skills Audit. This Audit, which is supporting current government-led developments around industrial and skills activism, is comprised of a number of strands, including:

- **A national assessment:** to provide a strategic national overview and assessment of immediate and emerging priority skills needs in both existing and emerging industries. This will also include a regional assessment, providing a consistent and comparable skills assessment across the UK;
- **Priority sector assessments:** to provide an assessment of the skills needs of selected priority sectors; and
- **Horizon scanning:** to provide an assessment of what the future may hold by scanning the horizon, exploring important emerging issues and developments and bridging policy-making in the short and long term.

Scope of research

The scope of this research is the financial services sector, which is comprised of retail and wholesale banking, insurance and asset management. The sector was selected for analysis on the basis of its importance to the UK economy.

These activities are covered by section K of the UK's 2007 Standard Industrial Classification (SIC) of Economic Activities, "Financial and insurance activities." This is also the area of activity covered by Financial Services Skills Council (FSSC) data. In addition to the segments above, these data sources also cover "Other financial intermediation not elsewhere classified," "Administration of financial markets" and "Activities auxiliary to other financial intermediation not elsewhere classified." However, we have not focused on these segments in this report due to the diversity of activities they cover and the relatively small share of employment they comprise (13 per cent in 2008).

Financial services are normally segmented along the three main activities of banking, insurance and asset management. We have used a further cross-cutting segmentation by customer type of retail vs. wholesale, as there are a different set of drivers relevant to each. For retail, we define customers as individuals and small and medium enterprises; for wholesale, we define customers as large corporations (typically international in profile), financial services companies themselves and government/public sector organisations.

Professional services, including those linked to financial services, such as accountancy, are not within the scope of this report.

The research has also taken into consideration relevant international trends and regional implications within the UK.

Objectives of this study

The objectives of this study into financial services can be summarised as follows:

- develop an overview of the economic, social and technical drivers of change for the chosen sectors and a discussion of why the sector is so important to the economy;

- develop an in-depth analysis of global and national trends in skills and employment within a selected sector; including skills insight and foresight and labour market impact. This needs to give consideration to the priority skills within the sector; and

- consider future challenges and trends for the sector, outline possible alternative sector scenarios and implications and consider how they impact on the labour market and skills requirements.

Our approach

Our study is based on in-depth desk research, interviews with industry stakeholders, analysis and scenario development to help the UK Commission understand the future skills needs of the financial services sector. It provides both a qualitative and quantitative view of these requirements and how they may evolve in the long-term. In conducting our analysis, we have drawn on the existing literature and national data on skills in the financial services sector.

We have also consulted with the FSSC, trade associations, employers and PwC's Financial Services team.

Key findings on current employment and skills

Different sources indicate that the financial services industry employs between 1m and 1.2m people. This represents c.4 per cent of the total UK workforce. Employment is weighted towards the banking segment (51 per cent of total financial services), followed by insurance (30 per cent), then asset management (6 per cent). The majority of employment falls within retail (63 per cent of total financial services) and retail banking as an individual segment employs 38 per cent of the financial services workforce. The sector is highly productive, generating GVA per head in excess of £100,000 and awarding average remuneration of over £40,000. Between 1998 and 2007, industry output doubled, but employment increased by only 2.2 per cent as productivity rose significantly. This was mostly due to wholesale activities, centred on London, and a reduction in the number of low value-adding support roles, either through technology or offshoring.

More than any other sector, employment in financial services has come under pressure in the recession. Anecdotal evidence suggests that total employment may have declined between 5 per cent and 10 per cent since it peaked in 2007. It is unlikely that the full impact of the financial crisis has yet been felt, so there may be more job losses to come. As this report is being written, the UK is the midst of a debate about banking remuneration and the behaviours it should be designed to encourage.

Financial services employees are generally educated to a higher level than the national average, with many positions requiring National Qualifications Framework (NQF) Level 4 or above. However, there are persistent skills deficits in financial services, although these are more pronounced in certain subsectors than others.

- Retail financial services generally suffer greater skills gaps and shortages than wholesale financial services. Retail financial services, which generally requires lower level qualifications and where a significant share of employees are school-leavers, is less attractive compared to competing sectors such as high-street retail. Financial services companies providing wholesale services have historically offered very generous remuneration packages, enabling them to attract the brightest people;

- Furthermore, insurance, in both the retail and wholesale markets, is less attractive to high-quality candidates than banking. In the wholesale market, there is a remuneration disparity with other financial services companies, in particular investment banks;

- There are shortages and gaps in both generic and sector-specific skills. It is worth noting that entry-level candidates for retail financial services jobs often lack the basic numeracy, problem-solving and people skills required, as well as basic industry and product knowledge;

- Skills relating to risk management and risk assessment are weak. Due to a lack of investment in this area, there is a current shortage of experienced and qualified risk managers and the shortage has been exacerbated by the need to respond to the financial crisis;

- There is a shortage of management and leadership skills across the sector.

- UK candidates for wholesale financial services positions have weaker language and cultural awareness skills than their non-UK counterparts;

- There are also sector-specific shortages, even for highly-skilled, well-paid jobs. For instance, there is an acute shortage of actuaries in the insurance industry. Investment banks have also noted a difficulty in recruiting UK graduates with sufficiently advanced mathematics skills, although they are generally able to source appropriate people from abroad.

Future outlook for employment and skills

The outlook for the financial services sector has changed significantly as a result of the financial crisis. Future levels of employment in the sector will depend on the government's response on regulation, the need for efficiency, consumer demand and globalisation.

We have developed a series of scenarios which illustrate a set of possible future states of the retail and wholesale financial services sectors. In five of our six scenarios, employment in financial services declines due to tighter regulation, a shift in consumer demand towards saving rather than credit and a gradual loss of wholesale market share relative to other international financial centres. Most of the scenarios, supported by our research and interviews, suggest that overall employment is unlikely to return to 2007 levels in the next decade, and could remain significantly lower. Specifically:

- wholesale financial services employment is the most volatile, particularly in investment banking and asset management. Employment is dependent on London's position as a global financial centre and there is an argument that this will be gradually eroded between now and 2020 as trade and capital shift to emerging economies; and

- employment in retail banking and insurance is less volatile, but as these sectors comprise the majority of financial services employment, a small percentage decline would still result in materially lower employment.

Overall, our view tends towards the more pessimistic of our scenarios. Whichever scenario emerges, it is likely that the distribution of jobs along the financial services value chain will change. We expect the shift towards higher-value, higher-skilled jobs we have seen in the UK to continue as certain functions are moved abroad or automated.

- Efficiency will be paramount in retail financial services as companies look towards recovery and the need to restore margins and profitability. There will be continuing job losses due to branch closures and moves towards more efficient distribution channels (phone and internet), negatively impacting front-office employment;

- Regulation could potentially limit the freedom of banks to innovate and result in polarised banking business models, with some banks focusing on core retail banking services, generating lower but more stable returns, and niche providers serving clients willing to take greater risk. Utility banks will seek to regain the trust of their customers, with positive implications for customer services employment. Recent marketing by banks such as NatWest, for instance, showcases the personal relationships financial advisers build with clients;

- As emerging economies become more important, client-facing front-office functions in wholesale markets will need to be established close to international clients. However, London-based clients will still need to be serviced from London;

- Globalisation and technology advances have enabled financial services companies to fragment their activities geographically to achieve cost savings. Significant proportions of the back-office have been exported to developing economies such as India and we expect this trend to continue and extend towards some middle-office monitoring and control functions, although some of these will need to remain close to the main financial exchanges.

There is likely to be a significant change in the provision of personal financial advice as a result of the Retail Distribution Review (RDR). New regulations will mean many independent financial advisers (IFAs) leave the market and encourage insurance and asset management companies to develop alternative sales channels.

In the next decade, there are likely to be many changes in the type of skills needed by the financial services industry. New roles will be created and existing roles modified or expanded. Most of the impact will be on the jobs that already exist; employees working at all levels in financial services organisations will need these skills in the new environment.

- Risk management and compliance skills, driven by greater regulation of financial services companies (both wholesale and retail) and demand for transparency among stakeholders. The need will be strongest in banks, which are likely to experience the greatest change in regulation, but insurance companies will not be exempt. Whatever the extent of increased regulation, there will be a greater need for accountants, actuaries and other professionals capable of assessing and monitoring financial risk. A new attitude towards and greater awareness of risk will also need to permeate financial services companies;

- Product knowledge and advice skills. The Thoresen review recommends establishing a free generic financial advice service targeted at less affluent customers which would impact the need for these skills in the third sector;

- In the wholesale sector, it is widely recognised that many financial services companies did not understand the risks associated with the complicated products they were buying and selling. While the effect will be most strongly felt by front-office staff, the need for better understanding will span all areas of financial services companies – middle-office staff and board members cannot control and assess the risk of front-office activities without fully understanding the products;

- Cultural and language skills will become more important as more business originates from emerging markets.

The government has a critical role to play in managing the sector in the medium-term and is currently formulating its response to the crisis, both in terms of regulation and remuneration and in terms of its role in supporting banks as a shareholder or a lender of last resort. The government's response will shape not only the structure of the sector and its competitiveness, but ultimately will impact upon levels of employment and the types of skills that will be required.

Six possible scenarios for the financial services sector

We have developed a set of scenarios illustrating potential future states for the financial services industry in 2020, based on analysis of the findings from desk research and interviews with industry stakeholders relating to the drivers for change in the industry.

Due to differing industry drivers, we have developed a separate set of scenarios for retail financial services and wholesale financial services. The primary drivers of retail financial services are regulation and consumer demand. For wholesale financial services, these drivers are regulation (relative to other jurisdictions) and the pace of globalisation.

The retail scenarios are:

- Scenario R1: “Laissez faire,” characterised by light regulation and consumer appetite for credit – a scenario that is similar to the last decade;

- Scenario R2: “Sustainable consumer finance,” characterised by moderate regulation and more balanced consumer attitudes; and

- Scenario R3: “Utility financial services,” in which restrictive regulation constrains innovation and consumers have cautious attitudes to credit and a greater appetite for savings.

The wholesale scenarios are:

- Scenario W1: “Business as usual,” in which the UK retains a light-touch regulation and the pace of globalisation is relatively slow, favouring London’s position as a global financial centre;

- Scenario W2: “Sustainable global finance,” characterised by moderate regulation that is consistent with other jurisdictions. The pace of globalisation means the UK, centred on the City of London, loses some share as a financial centre, but its position remains supported by strong infrastructure; and

- Scenario W3: “Shift to the East,” in which the UK regulatory environment is more restrictive than other jurisdictions and the pace of globalisation accelerates a shift of wholesale business to other financial centres in emerging markets.

In five of our six scenarios, employment in financial services declines due to tighter regulation, a shift in consumer demand towards saving rather than credit and a gradual loss of wholesale market share relative to other global financial centres. Most of the scenarios, supported by our research and interviews, suggest that overall employment is unlikely to return to 2007 levels in the next decade and could remain significantly lower.

Executive Summaries present the key findings of the research and policy analysis generated by the Research and Policy Directorate of the UK Commission for Employment and Skills. More detailed analytical results are presented in Evidence Reports and all are accessible on the UK Commission's website **www.ukces.org.uk**.

Produced by PricewaterhouseCoopers LLP for the UK Commission for Employment and Skills

UKCES
3 Callflex Business Park
Golden Smithies Lane
Wath-upon-Dearne
South Yorkshire
S63 7ER

T + 44 (0)1709 774 800
F +44 (0)1709 774 801

UKCES
28-30 Grosvenor Gardens
London
SW1W 0TT

T + 44 (0)20 7881 8900
F +44 (0)20 7881 8999

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