Operating Environment

Adapting to changes in our operating environment

Climate agenda

What we are seeing	How we are responding
Sustainability, and in particular the climate agenda, continues to grow in importance. It is an area that impacts all of our stakeholders and the decisions they make, and it guides our activities and operations as a business. The landscape is also rapidly evolving, whether that be through expectations of our business strategy, enhanced disclosure requirements or the need to incorporate climate factors into our stress testing. The expectations on us as a business are increasing alongside this. We recognise that we have an important role to play in helping people and businesses transition to a lower carbon future, supporting them to invest in green assets including electric vehicles, renewables, grid infrastructure and energy efficiency. We also need to support our stakeholders in making decisions by providing sufficient information on our climate strategy. Investors are increasingly taking ESG factors into consideration as part of their investment decisions and reporting standards require us to align our climate reporting to the recommendations of the Task Force on Climate-related Financial Disclosures ("TCFD").	We have made significant progress in developing our group climate strategy, considering both our operational impacts and the implications across our financed activities. As part of our group-wide climate commitment, we have become signatories to the Net Zero Banking Alliance ("NZBA") and Net Zero Asset Managers ("NZAM") initiatives, and will be outlining our interim targets for reducing emissions over the coming months. As part of our role in helping people and businesses transition to a lower carbon future, we have set an initial green growth ambition in our transport businesses – to provide funding of at least £1 billion for electric vehicles over five years. We have financed £164 million in the first year of this period. Our lending spans a diverse array of green assets including wind and solar generation and grid infrastructure, with new battery electric storage systems and sustainable house construction financed during the year. We continue to invest in building further our expertise in green and transition assets, reinforcing our reputation for specialist knowledge and finance. We are also working hard at reducing our operating emissions. Our third-party management team has been engaging with key suppliers on ways we can work together to reduce our environmental impact. We have established an employee climate committee and we engage our colleagues in monthly spotlights on sustainability, featuring guest speakers. Read more about our climate commitments in our TCFD report on pages 40 to 54.

Regulatory environment

What we are seeing	How we are responding
The UK regulatory environment continues to evolve, with a focus on ensuring the stability of the UK banking system and achieving positive outcomes for customers. Operational and financial resilience continue to be important to UK regulators and monitoring of regulated firms takes place on an ongoing basis through stress testing, capital and liquidity requirements including recovery planning, increasing regulatory data reporting requirements and regular supervisory meetings. The FCA's Consumer Duty has recently taken effect, with the objective of driving better customer outcomes. The PRA also published its consultation paper on Basel 3.1 standards in November 2022, with a final policy statement expected in late 2023, and proposed reforms of the UK's audit and corporate governance regime are expected to come into effect relevant to the group from its financial year starting 1 August 2025.	We continually monitor the landscape for regulatory change. We maintain a cooperative relationship with our regulatory bodies, including the FCA and PRA, who conduct regular monitoring of our position, including reviewing our stress testing of our liquidity and capital requirements. We have conducted in-depth reviews across our businesses and updated our processes and documentation where needed to align with the FCA's recently implemented Consumer Duty. Our focus is now on continuing to embed our compliance with Consumer Duty requirements and implementing Consumer Duty changes for books of business not open to new customers. We have assessed the expected impact of the Basel 3.1 standards, which, if implemented in their current form, would add up to 10% to our capital requirements. We have engaged with the consultation process to understand the impacts as proposed and to express our views on possible improvements.

Customer behaviour

What we are seeing

The expectations of customers when dealing with their financial services providers continue to evolve, with a customer's overall experience across the end-to-end journey key for building loyalty. Customer service, clarity of communication, price and value of products, the ease of doing business and, critically, how customers feel about their overall experience, are highly valued by customers.

Over recent years, we have seen a continued shift in behaviour as customers trend towards an increasing use of online channels and digital offerings, including self-service products. However, in spite of this digital shift, customers perceive experiences that combine physical and digital channels as better than single-channel experiences. Hybrid customer experience tends to create the most emotionally positive experience and as such, strong human relationships combined with high-quality customer service continue to be key drivers for delivering great customer experience and earning brand loyalty.

In light of the pressures on customers and businesses from the rising cost of living and higher interest rate environment, customers are increasingly seeking out better value for money with their choices, with switching between providers becoming more commonplace across many financial services products.

How we are responding

We have created our Customer Commitment to provide a framework for further embedding customer-centricity into our culture and daily decision-making. This framework outlines how we want our customers, clients and partners to feel when doing business with us – valued, happy, understood, confident and that it is easy.

Across the organisation, we have different products, routes to market and customer segments. Nevertheless, our Customer Commitment helps ensure that customer-centricity continues to be at the heart of our business and aligned with our purpose. We focus on providing excellent service and building long-term relationships with our customers, who benefit from the deep expertise of our people, with technology supporting our relationship-based model.

We have invested significantly in our digital capabilities across the organisation. In Savings, our deposit platform has enabled us to broaden our product offering with the launch of easy access accounts and cash ISAs, whilst achieving excellent customer satisfaction scores. In Motor Finance, we have introduced new channels for our customers who fall behind with their vehicle finance payments to catch up and pay. Our Property business has more widely rolled out the use of electronic signing, and our EkegPlus offering in Brewery Rentals gives customers greater visibility over usage and costs.

We used regularly captured feedback and insights from our customers, clients and partners across the end-to-end journey to evolve our proposition and meet their changing needs, and we are looking at how to enhance further our "voice of customer" capability. We consistently achieve good net promoter and customer satisfaction scores across our businesses, and are also working to improve further our complaints management process to complement this.

We value the long-term relationships we have with our customers and look for ways to reward their loyalty, for example by raising the interest rates offered to our Savings customers. Given the cost of living pressures facing our customers, we continue to work with them closely and look to provide additional support where needed.

Operating Environment continued

Technology and digital adoption

What we are seeing	How we are responding
As technology advances, we have seen a shift in customer behaviour towards an increasing use of digital channels and self-service models. Technology is also being used to drive improvements to customer experiences, for example through providing richer data insights, better monitoring of customer journeys and automating non-value-adding processes. The pace of technology change continues to increase, with digital disruption a key theme across the markets we operate in, albeit most industry activity to date has been targeted towards the more mainstream areas of retail banking. This increasing adoption of technology also poses a threat of cyber attacks and the need for continued investment in operational resilience.	As a customer-centric organisation, we are focused on enhancing technology to support our relationship-based model and make our experts more valuable. We are continually looking at technology propositions to service our customer journeys and respond to the wants of our customers based on the feedback we receive, ultimately enabling us to improve customer satisfaction. Investment in our Customer Deposit transformation programme in Savings has enabled us to diversify our product offering and grow customer numbers as we adapt to changing customer preferences to utilise digital channels. In Premium Finance, we are using technology to reduce the time taken to make credit underwriting decisions for large business applications. We are also increasing our use of cloud-based services, which provide more flexibility and adaptability for delivering change and further enable our agile ways of working. We benefit from a degree of protection given our niche focus and relationship-based approach and have not yet seen the same level of digital disruption in our more specialist markets as other areas of the banking landscape has. Nevertheless, we continue to invest in enhancing our digital infrastructure and proposition, as well as our operational and cyber resilience, with a multi-year strategic cyber resilience programme covering our people, systems and processes.

Economic outlook

What we are seeing	How we are responding
The last year has seen a heightened level of uncertainty in the economic environment from a combination of factors including the ongoing conflict in Ukraine, UK inflation reaching its highest level in more than 40 years and the Bank of England base rate rising to 5%, at 31 July 2023. As a result, individuals have faced rising cost of living pressures and SMEs have experienced increased operating costs. Furthermore, the long-term effects of the pandemic and the cessation of government support schemes could have an impact on both individuals and businesses. Volatility in the economic environment also impacted debt markets, with few wholesale issuances completed during periods of the year given the heightened uncertainty. Although current economic forecasts reflect improvements in variables including higher GDP growth, less pronounced house price reductions and less risk of further increases to the Bank of England base rate, economic uncertainty and cost of living pressures are expected to persist.	We recognise the challenging economic conditions and continue to monitor closely the potential impact on our customers, offering additional support where needed. Notwithstanding the economic uncertainty, we continue to support our customers and lend throughout the cycle on responsible terms, consistently applying our prudent underwriting and pricing discipline. The secured nature of our lending continues to offer some protection to the group's profitability. Our diverse funding sources enable us to adapt our position through the cycle, based on market conditions and demand. Although our average cost of funding rose during the year due to rapidly rising interest rates, we took actions to optimise our liability mix. Whilst wholesale debt markets were disrupted, we actively grew our retail deposit base, and subsequently successfully issued a £250 million unsecured bond when market conditions were more conducive. Our IFRS 9 models are regularly updated to reflect current economic scenarios and forecasts from Moody's and we have overlaid adjustments to recognise additional risk from the heightened uncertainty that persists.

Competitive landscape

What we are seeing

Given the highly diversified nature of our business, the competitive landscape is playing out differently across the group.

In Banking, the significant changes in the interest rate environment are impacting lenders differently, with current account banks benefiting from improved net interest margins while small, specialist and non-bank lenders reliant on wholesale funding are facing a more challenging outlook. The conditions may also drive consolidation in the sector, particularly at the smaller end as conditions for larger transformational M&A remain difficult.

In the Republic of Ireland, while the economic outlook remains strong, the landscape is not as competitive as the UK following the decision by some established lenders to exit the market over recent years.

The savings market remains highly competitive, with savings rates having risen from record lows to their highest levels since the financial crisis in 2008. We have seen a number of new entrants to the savings market in recent years, with high street banks, specialist lenders and fintechs all competing across the UK savings market.

In the wealth management industry, consolidation remains a key theme, with private equity backed consolidators looking to acquire IFAs and a number of large wealth management transactions driven by a need for scale.

For Winterflood, difficult market conditions have led to challenges for market makers and brokers, with a focus on managing costs and diversifying revenue streams while awaiting a sustained improvement in retail and institutional investor activity.

How we are responding

In Banking, we anticipate the changes in the interest rate environment may result in a reduction in credit supply, similar to what we have seen in previous cycles. Given our through-the-cycle model and strong balance sheet, the challenging outlook could provide opportunities for us as we retain our pricing and underwriting appetite and seek to maximise opportunities for loan book growth. We continually assess existing and new markets for growth opportunities that fit with our model.

We continue to believe that Ireland represents an attractive long-term market for Close Brothers. In September 2023, we announced our agreement to acquire Bluestone Motor Finance (Ireland) DAC, providing a platform for us to build our Motor Finance business in Ireland.

Our Savings business has become increasingly agile in its pricing to take advantage of market opportunities arising from increasing market rates and frequent competitor repricing. We are continually assessing the market to ensure our rates are priced fairly for our customers.

In CBAM, we continue to look for opportunities for small infill acquisitions in line with our growth strategy. Furthermore, we are seeing a number of wealth managers moving to a more centralised investment proposition, which presents opportunities for us to attract talented individuals to CBAM by offering portfolio managers the flexibility to service their clients' needs in a more decentralised model.

In Winterflood, we continue to diversify our revenue streams and explore growth opportunities, such as through WBS, balancing the cyclicality seen in the trading business. The diversification of our trading desk has also enabled us to take advantage of the increased retail investor interest in fixed income markets.