Banking top 10

Drivers of innovation and growth

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Economic conditions, a competitive landscape, innovation and the regulatory agenda are central focus areas among banks' management teams and boards as we enter 2023.

While banks will look for opportunities to continue to grow, we also expect banks to closely monitor loan demand, liquidity and funding mix, credit risk, and costs.

Through it all, though, there is room for cautious optimism ahead in the banking industry. The industry is strong in terms of balance sheet and earnings heading into 2023. The technology advances banks made in recent years have built a foundation for growth by delivering improved, digitally enabled banking solutions and innovative products. The tightrope banking executives will have to walk in 2023 will be how to drive innovation and growth in an increasingly cost-conscious environment and finding the right tech-savvy talent to help maintain momentum. These trends are impacting all areas of the business—and the broader economy.

What does all this mean for 2023?

Read on to learn more about the banking top 10 drivers for innovation and growth.

Banking top 10

Digital transformation

Digitization of banks' operating models is fundamental to growth and efficiency, and it is essential to the timeliness and accuracy of regulatory compliance demands along with the ability to create defenses against unabated cyber threats. We expect even more banks to take on core system replacement programs, along with leveraging cloud technologies and artificial intelligence projects as part of holistic transformation efforts. Banks' primary focus is on creating integrated, scalable digital operating models. Going forward, we expect an expansion of the foundational digitization elements as a means to realize a meaningful—and measurable—return on investment. In the coming months, look for significant efforts being placed on modernization to help with product innovation, real-time processing, and an array of customer needs. We are witnessing a new dynamic, where banking executives increasingly are embracing programs to digitize the enterprise—in the front, middle, and back offices—and building strategies and employing tactics that create new digital capabilities that benefit customers and the business.

Earnings growth

With a recession in the United States remaining possible (perhaps likely) in 2023, top-line revenue growth will become more challenging for most banks. Banks will focus on maximizing their net interest margin as interest rates stabilize and competition for deposits increases. Managing credit will also be at the top of most bank executives' agendas going into 2023 as the economy slows. Given the significant growth in costs we expect banks to look hard at cost reduction and efficiency improvement in the coming year. Banks are pursuing three distinct types of efficiency-related initiatives, sometimes in tandem: First, institutions looking to close earnings gaps in the near term are reexamining the "low-hanging fruit" of cost reduction, including optimization of spans and layers and staff capacity, and reductions in procured costs. Second, institutions are investing in digitization and automation of core processes, transformation and cloud-migration of core infrastructure, and development of "digital-first" business models for segments such as commercial and small business. These initiatives will require up-front capital expenditures and have longer payback periods but will yield more efficient and scalable business models over time. Third, we also see banks working to break out of "boom and bust" cost management cycles by developing more disciplined and proactive continuous performance management approaches, including supporting metrics, incentives, and cultural change.

Finally, while we expect significant near-term focus on cost, forward-looking banks will also be positioning to deliver strong revenue growth when the economy recovers from its anticipated downturn. One important consideration to that end is ensuring that any near-term headcount or capacity reductions will not impair the institution's ability to originate and service new business in the early stages of the recovery. Missing out on revenue opportunities due to overaggressive capacity management and being forced to re-add capacity in a hot labor market are serious potential risks to earnings growth in the latter half of 2023—or whenever an economic downturn reverses. A second important consideration is continued investment in alternative, innovative business models. API-led open banking, embedded finance, open platform, and banking-as-a-service strategies are, for most institutions, nascent at best, but likely to drive significant earnings growth in 2024 and beyond for institutions that invest and execute decisively now.

Payments

Core infrastructure modernization through the leverage of advanced payment platform technologies is at the heart of banks' desire to speed up payments in banking in 2023. Customers would benefit through user-friendly, quicker transactions; banks would improve customer relationships and reduce costs by limiting process redundancies and speedier operations. We expect more alliances with nonbank and third-party organizations, enhancing agility and bringing aboard more technical talent to traditional banks. Additionally, we believe banks will place great emphasis on their progress toward adherence to ISO 20022, the global standard meant to enable interoperability among financial institutions and eventually eliminate today's plethora of proprietary payment formats.

Mergers & acquisitions

Bank deal activities, especially among mega- and large regionals, is likely to remain subdued into the first quarter of 2023, and perhaps beyond, because of rising interest rates, inflation concerns, and regulatory "overhang." Still, there are indications that activity among midsize and smaller institutions could be steady or even pick up in 2023, especially if some of the economic uncertainty and potential political gridlock issues are clarified in the months ahead. The steady pace in that sector we expect will continue to be driven by the need for scale and access to improved digital technologies, which remain essential for a litany of financial and business-process reasons. Further, brisk activity among banks of all sizes and nonbanks (fintechs) could increase due to an expanding need for better customer interaction and relationships, reduction in process costs, and the drive for increases in revenue and profitability. Some areas of uncertainty across almost all potential deals are technical debt and talent availability.

Risk & regulatory

Risk management

Anticipate a rise in banks' risk management profiles if credit conditions deteriorate, driven by a contracting economy, continued supply chain challenges, and pressure to maintain profitability levels. Certain industries will be more susceptible to economic pressures requiring earlier attention than others; early warning signs will be key. Concurrently, as banks leverage more digitized processes as a cost-reduction strategy and in order to reach customers more efficiently, risk management strategies should be embedded as part of the development of these emerging areas. High among the possible risks in 2023 due to a contracting economy are increased bad debt reserves, more write-offs, tightened liquidity, and the need to determine whether current models match current economic conditions. Bankers will be under pressure to not only embed risk management capabilities into their newest digital tools in order to maintain appropriate oversight but also to eliminate risk management redundancies. Should economic conditions worsen, bank executives will need to increase vigilance over risk taking as some employees may be tempted to cut corners in the pursuit of business results. Vendor-risk management should rise as banks increase the number of third parties they use as part of their efforts to cut costs and offer new digital products and services to customers. These matters are further complicated by the evolving capital regime being adopted by regulators around the world, prompting organizations to reconsider asset composition, structuring options, and customer profiles. Further continuing evolution of business models to digital platforms, heightened geo-political risks, and climate concerns have elevated the focus on and importance of operational risk and resilience, including third-party risk management and dependency.

Regulatory environment

Regulators are relentlessly pursuing what they perceive to be "weak links" within risk programs and coverage. Regulatory agencies in 2023 will continue executing against their broad and ambitious agendas. Expect increases across supervision, enforcement, and investigations under both old and new regulations—even with a heightened discord in public policy and increasing judicial challenges to regulatory authority.

The KPMG Regulatory Insights practice has released the Ten Key Regulatory Challenges of 2023, featuring client perspectives, key regulatory recaps, and actionable steps to help mitigate risk.

Read the full report.

Cybersecurity

Continued digital transformation will accelerate cybersecurity needs. There will be special focus on client identity and access management to protect customer data and reduce fraud. As technical debt grows, so do cyber risks: The increase in cyber vulnerabilities presents banks with the need to invest in reducing technical debt, although economic concerns may create pressures to slow such spending. Activity by organized cybercriminals is expected to increase in 2023 as they take advantage of vulnerabilities created by rapid digitization and increases in technical debt.

We expect that as incidents continue to escalate, regulators will turn up the pressure on banks to increase focus on managing cybersecurity threats. We anticipate significant focus on data protection through improvement of data management programs. Through it all, banks will continue to face shortages in talent as many industries compete for a limited supply of cyber specialists. All of these issues will be exacerbated as banks expand use of third parties/vendors. Formalizing third-party assessment programs will be a critical challenge in 2023.

ESG

Even as environmental, social, and governance (ESG) data has become essential information for stakeholders (investors, regulators, credit-ratings analysts, and consumers), uncertainty around the scope and timing of the SEC's ESG-related disclosure proposals (cyber, climate, and human capital) and evolving bank regulatory guidance has made it challenging for banks to determine next best actions for enhancing their ESG programs. Faced with inflation and a potential recession in 2023, banks are closely monitoring expenses and making tough decisions about which projects to fund, including ESG initiatives. In our view, there are steps we think all banks can and should take in 2023 to meet investor and stakeholder demand for transparent ESG disclosures and to help progress toward being ready for ESG regulation:

- Inventory all publicly disclosed ESG disclosures
- Educate management and the board on the ESG regulatory landscape
- Subject existing ESG disclosures to your disclosure review committee process
- Assemble a cross-functional team to implement the reporting and control requirements, including the use of an ESG-designated reporting platform
- Take the next step in identifying and calculating your greenhouse gas emissions.

While the draft principles for climate-related financial risk management released by each of the federal banking agencies (Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation) are targeted at institutions with over $100 billion in assets, we believe that banks of all sizes should understand the climate-related risks they face and implement the framework the agencies have outlined (note: a joint, inter-agency release is expected in 2023). The New York Department of Financial Services has similarly proposed guidance for all of its supervised banking institutions, specifically adding that smaller institutions may not be less exposed to climate risks than large institutions and should take a proportionate approach to managing this risk.

Providing a clear understanding of the bank's ESG initiatives to stakeholders, and a more complete disclosure program, may enhance trust and unlock value. Additionally, banks are assessing the pros and cons of undergoing assurance audits of various ESG data to lend credibility to the metrics disclosed currently or that will be disclosed to meet any eventual regulations.

Innovation

Recent events have created a cautious environment surrounding digital assets. While investment in these assets and underlying technologies could grow in the years ahead, heightened regulatory oversight seems likely in the near term. Given current circumstances, we expect banks will review their strategies and adjust, as needed, to reflect the current environment.

Separately, interest by banks in building a metaverse environment remains high. Cliff Justice, KPMG leader of Enterprise Innovation, says the virtual environment hinges on advances in Web3, a decentralized environment built on blockchains: “The way we look at it, it’s not just augmented reality and virtual reality. It’s really the next iteration of the internet. It really encompasses everything that the internet would encompass, but it’s more interactive.”

The metaverse and Web3 are expected to reshape the way businesses and consumers engage, transact, socialize, and work. The precursors to the metaverse—extended reality, blockchain, and new payment rails—can provide a glimpse into the future possibilities of the metaverse. And while it is very much an uncharted territory, banks that start taking a few steps in the metaverse can begin to build a brand, prepare to acquire targeted customers, and learn how to leverage the medium to deliver products and services.

Talent

Personnel possessing specialized technology knowledge will continue to be in demand in 2023. Add to that requirement a need to meet diversity goals, and the talent question takes on even more urgent dimensions. The competition will be fierce although, for some, the urgency may be complicated by the simultaneous need to manage costs in the current uncertain economic environment.

There are mitigating factors in play. At the moment, it is unclear if banks will be able to tap into the technology talent that became available due to the late-2022 layoffs at big-tech firms. What remains unclear at the moment is whether many of those laid off possess the specific financial services skills that are required in the banking industry.

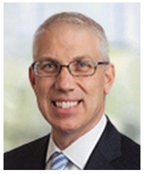
There also is another issue: Employers must be mindful of employee retention as workers' requests for a more flexible work schedule, an expansion of benefits, and other similar demands are still top of mind.

Tax

Political and economic uncertainties will mean banks' tax departments will need to focus on increasing agility as we enter 2023. In addition to adapting to the changing economy and evolving business model, tax departments need to prepare for guidance on the tax laws enacted in 2022, potential changes to foreign taxes, and hoped-for alterations to the tax-law changes created in 2017. Bank tax specialists are in an unenviable position of having to wait for clarity while also trying to create tax plans for the current year and the year(s) ahead. Nevertheless, we are seeing that forward-thinking tax personnel in banks are increasing investments in more advanced modeling or forecasting capabilities to improve their ability to respond to the uncertainties.

As is the case across the organization, tax departments will require specialized technical talent to help speed up processes and increase accuracy. The digitization of the tax function will be a critical challenge moving forward, although the pace and effectiveness of digitization will hinge on a bank's willingness to invest in—and the availability of—talent. We also expect that there will be pressure on banks' sourcing and staffing models.

Contact us



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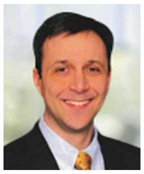

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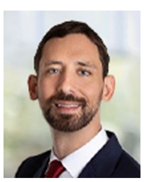

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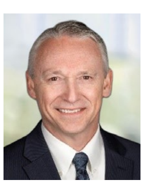

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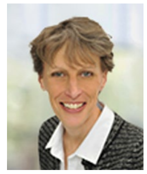

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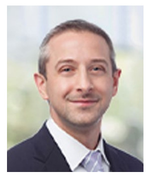

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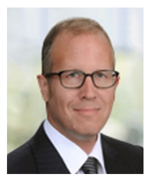

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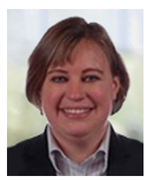

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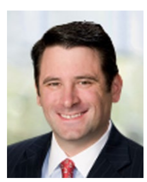

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