



The need for speed

2016 Banking Industry Outlook Survey





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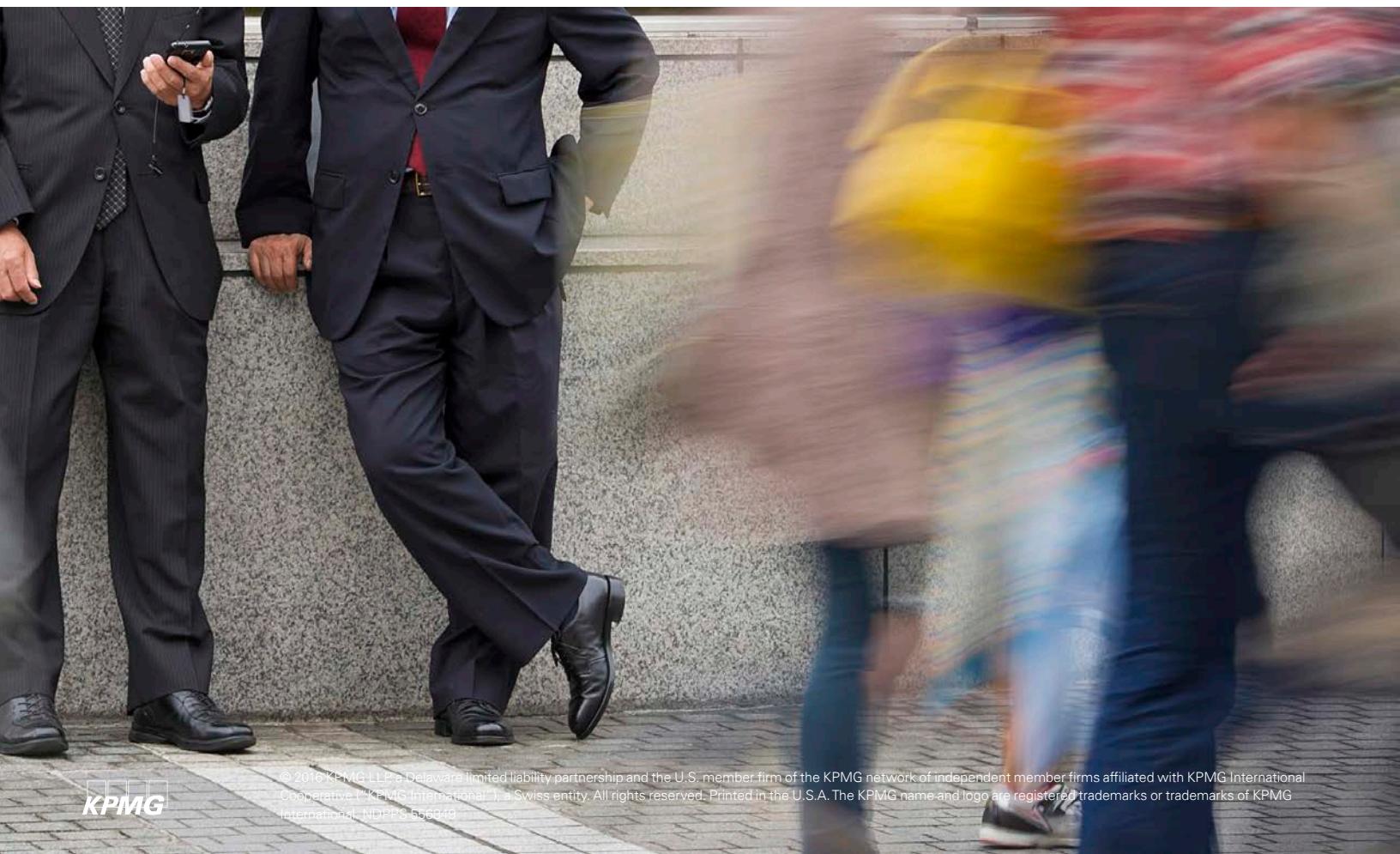
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Moving forward faster

It's no secret that slow and steady no longer wins the race. Yet, for banks, the need for speed is becoming more important than ever before.

Banks have certainly made progress in recent years. In many respects, they are in good shape and are optimistic about the future. In fact, 87 percent of the 100 US banking executives¹ surveyed in our 2016 Banking Industry Outlook Survey foresee revenue growth over the next year. Approximately two-thirds of respondents believe their organizations are actively embracing change, and more than half rate their current digital capabilities in the above average to excellent range.

But perception today may not match reality tomorrow. There is much more to do. And quickly. Today, any and all parts of a bank's business model are fair game. Newer, tech-savvy entrants have speed and agility on their side and continue to successfully nip away at different facets of a bank's business. Meanwhile, consumer expectations of highly personalized experiences continue to evolve daily.

So how fast is fast enough? For banking executives, this question looms large. Depending on bank size, strategic priorities will differ but common challenges remain. Managing costs, upgrading outdated legacy IT systems, complying with evolving regulation and changing a process-driven culture are just a few. In addition, they also must grapple with their own identity. Bankers by tradition, are typically risk-averse, long-term strategic planners—the antithesis of the tech entrepreneur rapidly encroaching on their space.

A key to future success will rely on banks' ability to fully integrate digital into their business. This means going far beyond digital capabilities on the front-end and instilling a core focus on the customer that permeates every aspect of the organization. Banks continue to incorporate digital capabilities and recognize the need to continually innovate the customer experience. However, digitization has not yet become a foundation for their business. Therefore, to keep their home field advantage, banks will need to continue making adjustments to their business model, incorporate new and emerging technology in ways that customers will find favorable, and adapt a truly digital mindset across the entire organization.

Change is, and will continue to be, hard. Still, as you will see, many of the results of our survey indicate positive strides in the right direction. However, they also serve as a reminder that time is of the essence. Banks need to accept it's no longer a race the big and strong are guaranteed to win. Speed and agility count just as much...if not more. And the time to accelerate is now.

¹ Responses in our 2016 Banking Industry Outlook Survey include senior executives at 70 of the largest banks in the U.S., which hold nearly 80 percent of all banking assets in the U.S. banking system.

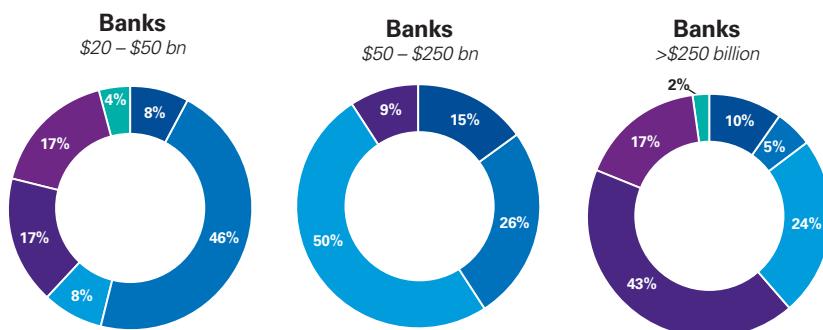
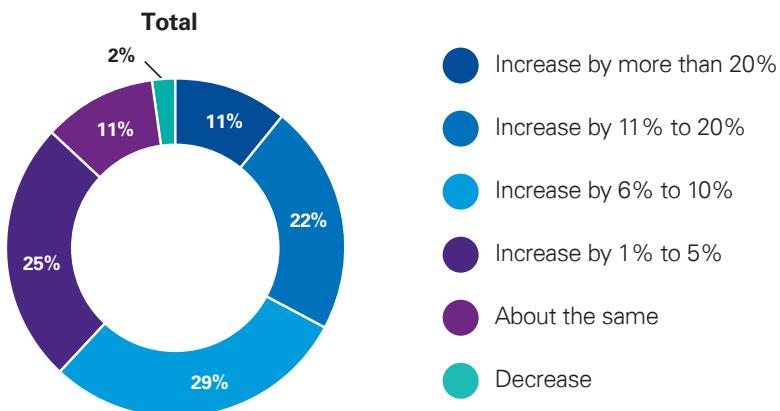
Gaining ground on growth



The long-awaited banking technology revolution is taking root. It's true the progress to date has been small, and much work remains before fundamental changes gain real traction, but banks continue to move in the right direction. And the positive momentum is clear.

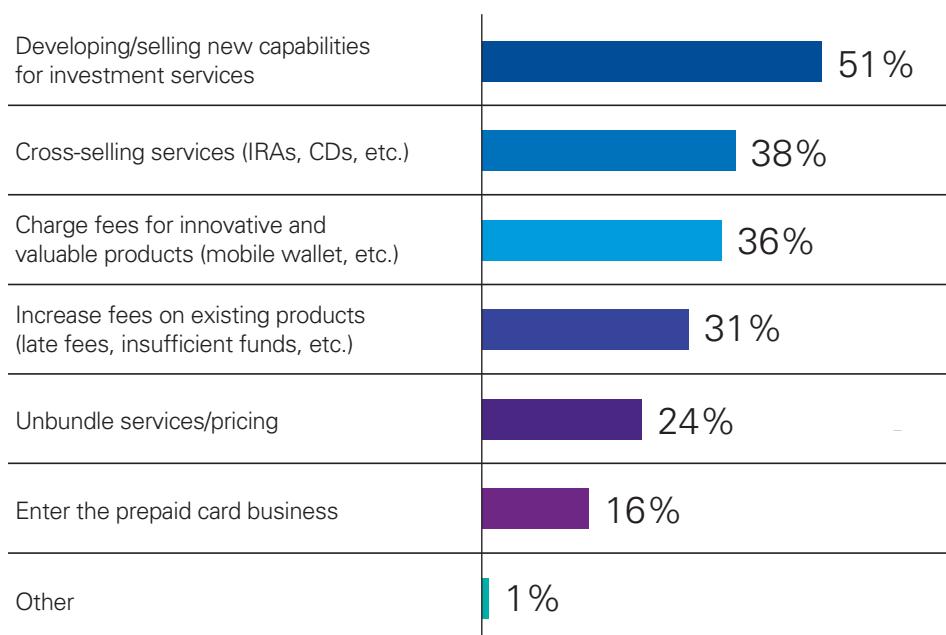
Our survey results reveal optimistic expectations as 87 percent of the banking executives surveyed foresee revenue growth in the year ahead. Larger banks are more modest in their growth predictions, with 43 percent expecting to see growth of up to five percent, while 46 percent of their smaller counterparts are more optimistic, anticipating revenue growth in 11 to 20 percent range in the next twelve months.

Q: How do you expect your company's revenue to change in the next 12 months?



According to survey respondents, the top three growth drivers include developing and selling new investment services, cross-selling services and charging fees for innovative and valuable products. It's worth noting that many of the sources banks are relying on for future revenue growth are underpinned by digital technologies—and the field for those services is becoming increasingly competitive as financial technology (fintechs) and other tech companies chase after the same valuable margins.

Q. What specifically is your bank doing to drive revenue growth?

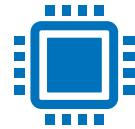


Key takeaway:

The optimistic expectations for growth signal that banks see real opportunities ahead. Despite an increasingly competitive landscape, new revenue opportunities will likely be found by increasing personalized services to customers. Banks willing to seize the opportunity to become innovators of new products and services by embracing disruptive technologies and transformative forces will be better positioned to reach growth targets.



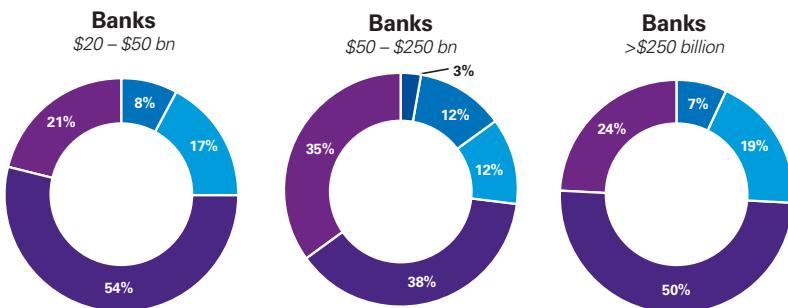
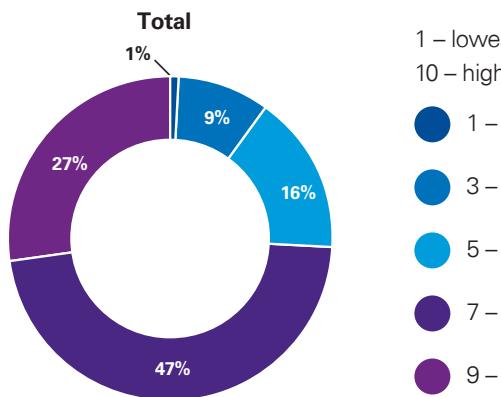
Driving digitization home



As they move forward on their transformation journey, banks are showing signs of digital progress. According to the executives in our survey, more than half are feeling pretty confident about their bank's digital capabilities, with one in five rating them an excellent score of 10. Larger firms are especially satisfied, with 91 percent rating their digital banking capabilities in the 6 to 10 range, representing an above average to excellent rating.

And customers seem to agree. The nation's six largest depository institutions-- Bank of America, Citigroup, JPMorgan Chase, PNC Financial, U.S. Bancorp and Wells Fargo-- scored higher than their smaller peers in overall customer satisfaction on digital offerings, according to a recent consumer marketing survey². This is the first time larger-sized banks took the lead over their mid- and small-sized peers in this category since the annual survey began in 2006.³

Q. How would you rate your organization's digital banking capability (e.g. mobile bill pay, mobile deposit, etc.)?



² U.S. Retail Banking Satisfaction Survey, JD Power & Associates, 2016

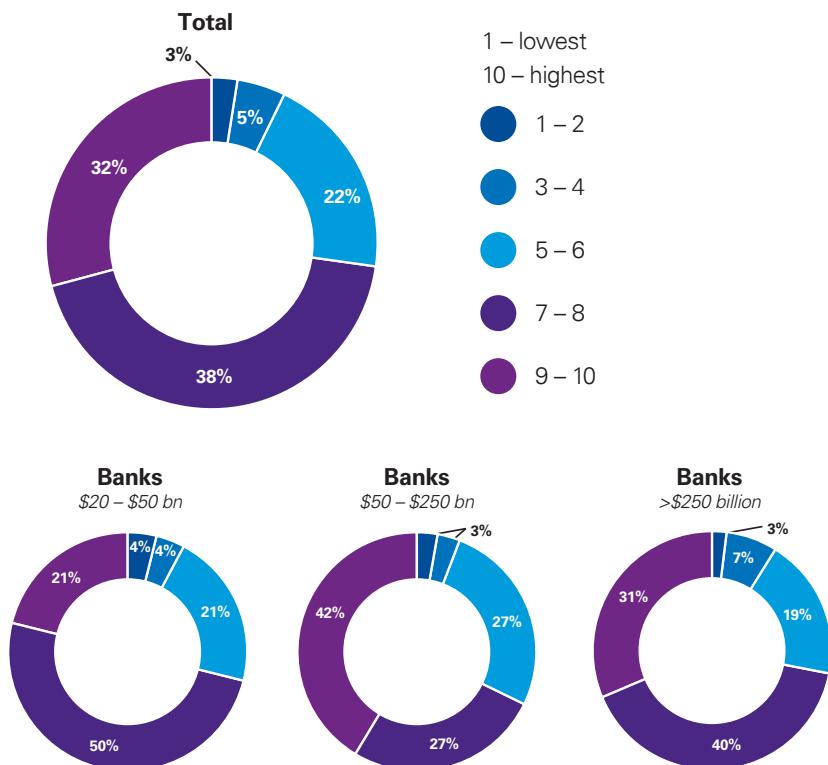
³ "That's a First: Biggest Banks Top Customer Satisfaction Survey", American Banker, Feb. 2, 2016.

It's clear that the name of the game is personalization. According to the Bank Administration Institute (BAI), 48 percent of 21-to-24 year olds believe high-quality personal service from banks is more important than financial expertise, and 44 percent of 25-to-34 year olds and 37 percent of those 35 and older feel the same.⁴

More than half of our survey respondents believe they offer the type of apps that customers want, rating them as above average to excellent. While some apps may be rated highly by customers now, the barometer is always changing as evidenced in the retail industry, which is continually upping the ante. Therefore, it's important for banks not to get too complacent in this space as ongoing innovation is necessary to keep pace with rapidly rising customer expectations.

According to Forrester Research, most financial firms have been slow to reengineer websites and apps that enable highly personalized digital experiences. They predict that digital disruptors like Digit, Mondo and Moven will show incumbents how far personalization can be pushed in financial services this year⁵. Furthermore, they believe that customers will respond to brands that use context and predictive tools to offer personalized advice and recommendations.

Q. Rating of ability to create and deploy banking apps customers want to use



⁴ *Digital Banking and Analytics: Enhancing Customer Experience and Efficiency*, BAI, April 2015.

⁵ "Predictions 2016: Financial Services Execs Wake Up to Digital Transformation," Forrester Research, November 10, 2015



Key takeaway:

Are banks faring as well digitally as they think they are? Customer perception may not exactly sync up with banks' highly favorable self-assessment in this area. In our survey, banking executives self-rate their digital capabilities very high but evidence suggests they may be missing the mark in certain demographic segments. Consider the results of the Millennial Disruption Index, a three-year study by Viacom Media that surveyed over 10,000 millennials, which revealed that 73 percent of respondents would be more receptive to financial services from Google, Amazon, Apple, PayPal or Square over their own banks. Moreover, 53 percent of millennials think their bank does not offer anything different than other banks.

Digitization is more than IT capabilities. As defined by Gartner, digitization is the use of digital technologies to change a business model and provide new revenue and value-producing opportunities. It is the process of moving to a digital business. So, while it's true that banks have improved on their digital capabilities on the front-end, digital enablement across the enterprise still has a long way to go. Banks need to leverage emerging technologies on the back end to massively scale their operations, employ smarter analytics, streamline processes and remove silos, seize the potential of digital labor opportunities, achieve cost efficiencies, and innovate to create the type of highly personalized experiences customers increasingly expect. While, IT helps create the capabilities of digital businesses they are only part of the equation. It takes an innovation mindset with digital skills and expertise embedded throughout the organization to drive real transformative change. So, while banks have indeed made steps in the right direction, they must forge ahead on their transformative journey. This means taking steps now to enable digitization across the enterprise by seeking to reengineer business models that foster innovation and focus on the customer.

Leveraging the fintech explosion



Key takeaway:

With the sheer volume of fintech startups, a shakeout of winners and losers is inevitable. Still, Forrester points out that overvalued fintech startups won't slow or diminish the impact of digital disruption, nor will they reduce the need for digital teams to innovate to meet customers rising expectations. Banks should continue to seize the opportunity to invest in, align or partner with these innovative tech startups that offer banks immediate agility, flexibility and speed to market. Such a coupling gives banks the advantage of both digitizing the experience while leveraging their own legendary ability to foster personalized relationships.

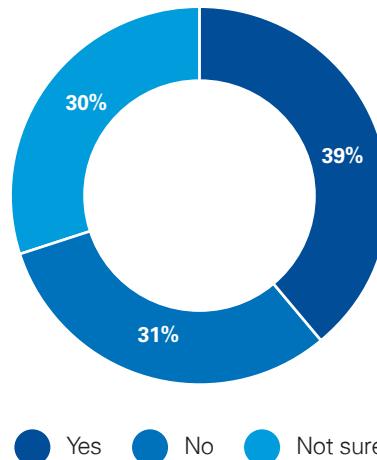
Much has been written about financial technology startups and their assault on traditional banking. In the past five years more than \$12 billion in funding has flowed into the fintech market⁶. In the past year alone, the number of fintech "unicorns"—startups valued at \$1 billion or more—has more than tripled from 11 to 36.⁷ And an estimated 4,000 firms are challenging banks in every product line in their portfolios—from payments to lending to foreign exchange.⁸

Despite such activity, more than 60 percent of banking executives in our survey do not view or are unsure of the threat fintechs pose in the near future.

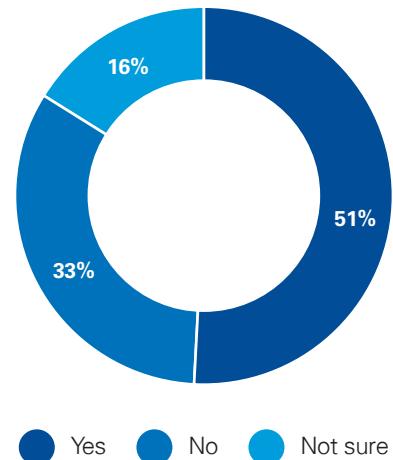
Perhaps this is because many banks are quickly realizing opportunities to join forces. More banks are forming ventures with innovative financial technology companies to help address an array of challenges that can help grow the industry, align it with the digital interests of business and retail customers, and tackle some of the vexing operational and data legacy issues that weigh heavily on the banking revolution.

For example, many fintechs are engaged in the profitable business of consumer lending, and in competing for customers, their speed and user-friendly apps set the bar high for traditional banks. As our survey results indicate, approximately half of the bank executives surveyed say they have already aligned with fintechs to cater to the consumer lending market.

Q. Do you and your bank colleagues consider fintechs a significant threat to your industry in the next few years?



Q. Has your bank already created a strategic alignment or joint venture with a peer-to-peer lender or marketplace lender for the purpose of creating consumer or business loans?



6 Predictions 2016: Financial Services Executives Wake Up to Digital Transformation, Forrester Research, November 10, 2015.

7 Fintech Innovations Signal Imminent Disruption, Bank Innovation, August 6, 2015.

8 The Disruption of Banking, The Economist Intelligence Unit Limited, 2015

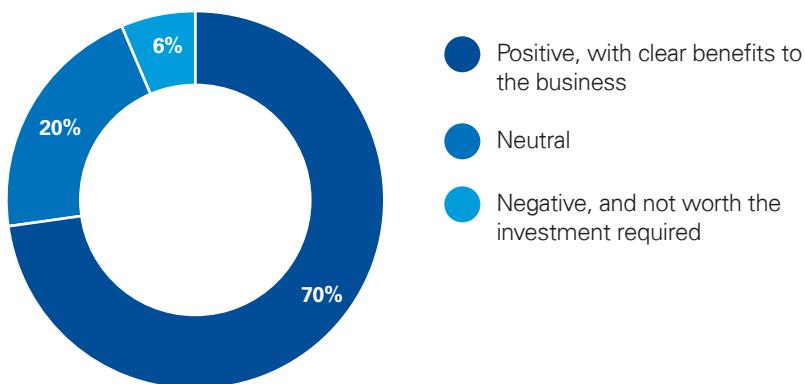
Seizing real-time payment opportunities



Real-time payments are on the horizon. They've already been mandated and/or implemented throughout Europe and Asia and are in use in Africa and South America.⁹ And the U.S. may not be too far behind.

While nearly three-quarters of the executives we surveyed have favorable views regarding the business case for real-time payments, many of the U.S.'s largest banks don't plan on participating in the first wave of this transformative advance. While 29 percent of the executives said they plan to be first movers, more than half of the executives surveyed (52 percent) said they'll wait to participate until one to two years beyond the initial launch.

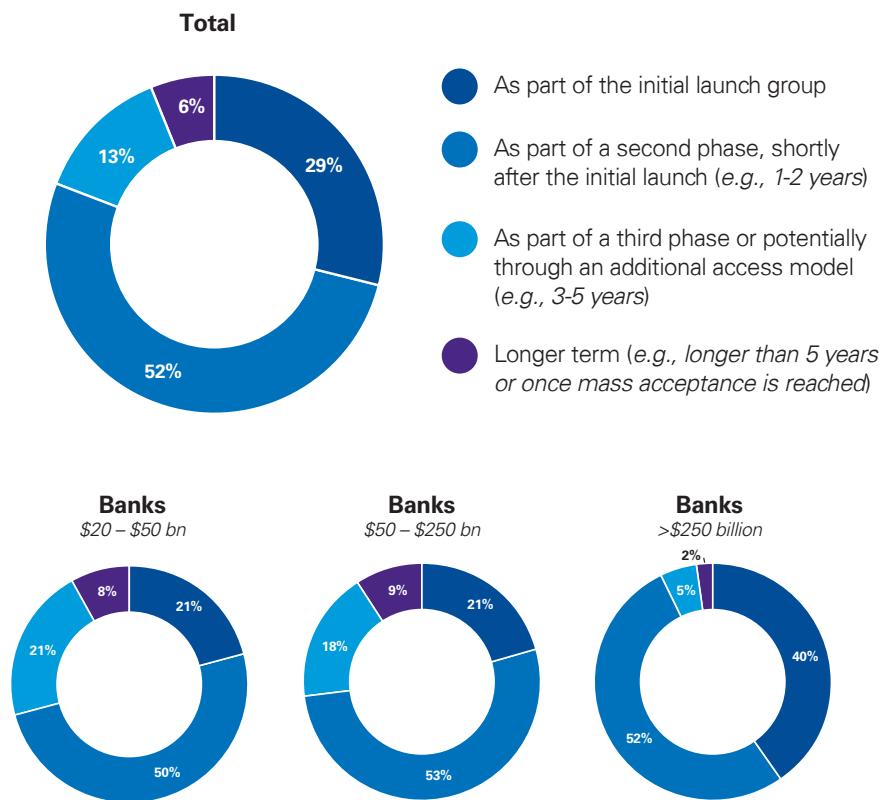
Q. What do you believe to be the state of the business case for the deployment of real-time payments in the U.S.?



Key takeaway:

From our point of view, waiting in the wings will leave pieces of a bank's business vulnerable to fintechs and other technology companies—who stand to benefit substantially by being in the first wave. Taking a slower approach to real-time payments means losing valuable revenue streams to those ready to jump on ripe market share opportunity. While joining in early will mean developing real-time payments infrastructure, new technologies such as blockchain may offer new potential by developing a decentralized approach.

Q. Assuming a new payment rail/platform is introduced to facilitate real-time payments, when would your bank begin to participate in a universal plan?



⁹ SEPA for Corporates. Real Time Payments Systems Around the World. Accessed at <http://www.sepaforcprates.com/sepa-payments/real-time-payments-systems-around-world/>

Banking on digital branches

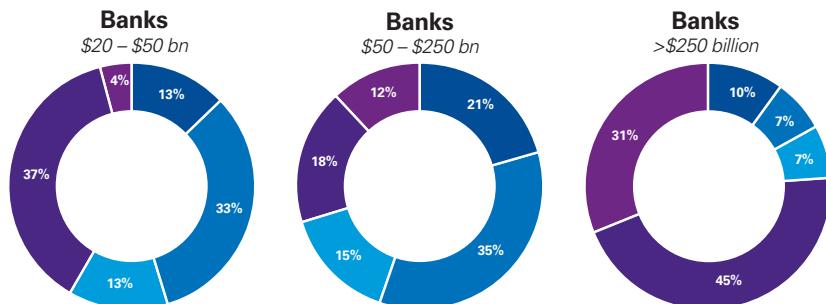
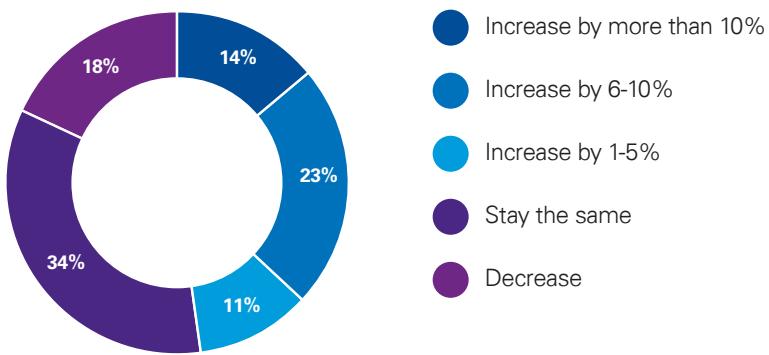


The bank branch still has an important role to play in a bank's omnichannel strategy. Similar to retail, bank customers expect the same high quality experience with all their interactions regardless of the channel. In fact, Gallup finds that customers are far more engaged with their bank when banks can align with their preference to be served digitally, physically, or both.¹⁰

Therefore, it's not surprising that more than half of the executives in our survey (58 percent) said they plan to increase their brick-and-mortar branches, with nearly a quarter saying that increase would be by a significant 6 percent to 10 percent. Respondents from banks with smaller asset sizes have more ambitious plans to increase branches than their larger counterparts. Larger banks indicated that they would either keep the same number of current branches (45 percent) or decrease the number of branches (31 percent). Since larger banks are spending far more on digital channels, such findings suggest that they are looking for a return on their digital investments over branch expansion.

Q. In the next 12-18 months, does your bank plan to increase or decrease brick-and-mortar branches?

Total



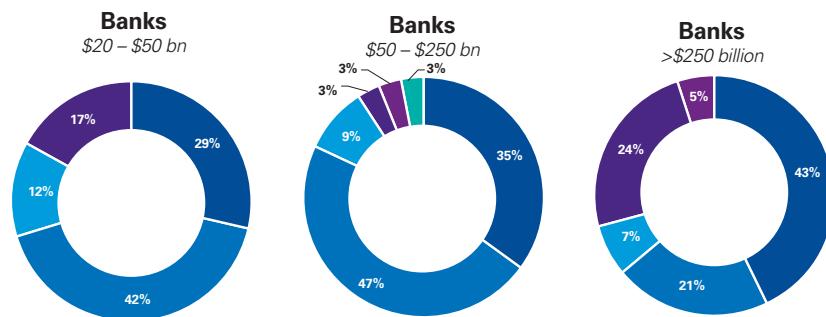
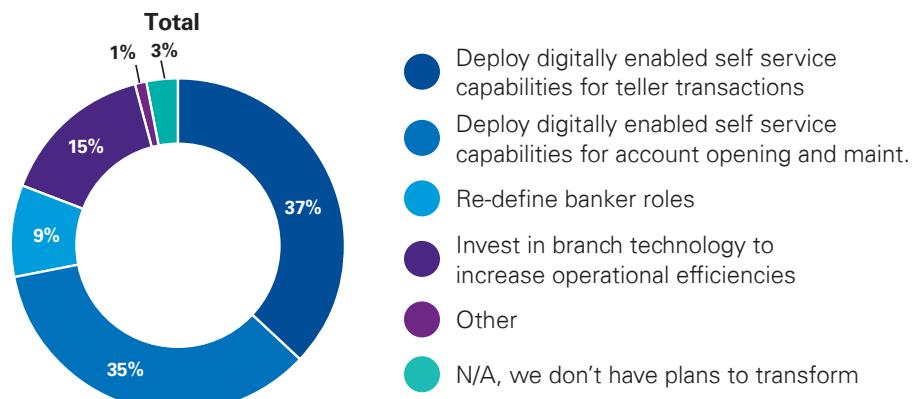
10 Most Banks Would Trade Personal Banking for Digital Banking. By Beth Youra, Gallup.com, April 17, 2015



As banks continue to blend physical and digital touch points to deliver better customer experiences, Forrester¹¹ expects they will need to do more to keep up with the competition and may explore new approaches such as augmented reality tools on mobile apps, guided selling tools on digital in-branch experiences, and onboarding with human guidance provided via two-way video.

While some customers may be visiting brick-and-mortar bank branches less frequently, the customer who makes the trip may find the place transformed into a self-service branch. Mid-size banks are taking the lead, and a full 82 percent say self-service is their key priority. Not far behind are smaller banks in our survey, where 71 percent say self-service is their top priority.

Q. What is your key priority for transforming the branch experience?



¹¹ *Predictions 2016: Financial Services Executives Wake Up to Digital Transformation*, Forrester Research, November 10, 2015.

Customer engagement with a bank drops when customers don't interact with their bank in the way they want to, but it also drops – by 40 percentage points – when they give a less-than-perfect satisfaction score to even one of the channels they use.¹²

Impact of channel satisfaction on engagement



Key takeaway:

Technology is changing the bank branch as we know it. Already, bank branches are seeing more self-service options, increased value-added offerings and smaller footprints. And, biometrics and other evolving technologies will open the door for new bank branch functionality and customer service possibilities. As a result, the branch continues to have an important –and evolving– role to play in a bank's strategy. Customers still want to engage with a bank on their terms and across all channels—personal, digital or both. The key for banks of every size will be meeting customer expectations across every channel to provide a satisfied customer experience at each and every touch point, including the branch. Customer service missteps can be very costly as customers are less forgiving when they have a multitude of alternatives to choose from. Engagement declines when customers don't interact with their bank in the manner they prefer, but it also declines significantly when they are not satisfied with the customer service provided in the channel selected. (see graphic on the left)

¹² Most Banks Would Trade Personal Banking for Digital Banking. By Beth Youra, Gallup.com, April 17, 2015.

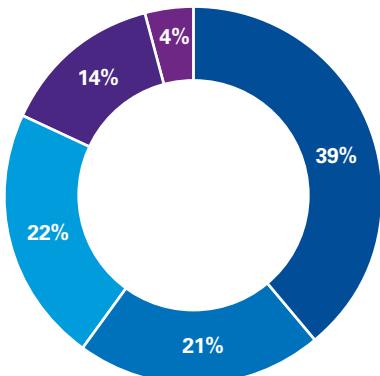
Getting up to speed with IT



Out with the old and in with the new. If only it were that easy. Outdated legacy IT systems continue to plague most banks. Yet, the time, investment, complexities and the potential risk of failure continue to hinder replacement of IT core systems.

Despite the sense of urgency needed to fix this challenge, only 39 percent of respondents report they have begun replacing their legacy IT system. Another 21 percent are only in the planning stages. And more than a third (36 percent) of executives in our survey said they are evaluating whether to replace or upgrade their system.

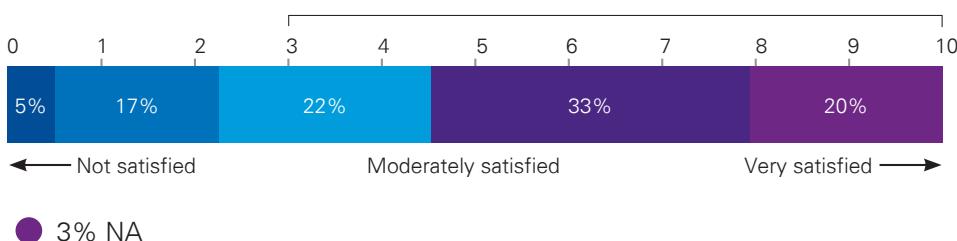
Q. Would you describe your bank's legacy IT system upgrade strategy?



- We have begun replacing the entire core system and expect the job to be complete over the next 2-3 years
- We are now in the planning stages of replacing the entire system
- We are evaluating whether to replace the entire system
- We are evaluating whether to upgrade elements of the system
- We have not begun any planning or evaluation of core system replacement

Perhaps more counter-intuitive are these results. When asked whether they were satisfied their legacy IT system would take them into the future, nearly three quarters indicated they were moderately to very satisfied (6-10 range).

Q. How satisfied are you that your bank's legacy IT system is sophisticated enough for tomorrow's future demands of your bank and the regulatory environment?





Key takeaway:

Again the need for speed is undeniable. Older bank legacy systems have been an ongoing challenge for most banks that are concerned with the time, investment and risk of replacing a whole core system. As a result, many banks are taking varied approaches to modernize their IT infrastructure, such as adding middleware and front-end systems to their core systems to orchestrate back office IT silos. The goal is to have flexible core platforms that enable easy data sharing and integration to continually evolve the customer experience. Therefore, banks would be best served by investing in a single IT platform to standardize processes, create efficiencies, lower costs, improve the flow of information and provide a common and consistent view of data integrated throughout the enterprise.

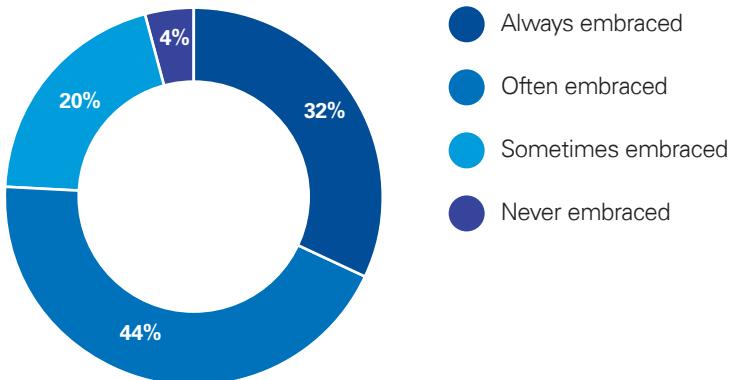
Promoting change from within



Keeping pace with transformation and innovation in the banking industry ultimately requires a company culture that is closely in step, one that is fully accepting of not only change, but also the speed at which innovations are taking place. Banks are monolithic institutions and such change does not come easy. Yet our survey results reveal progress in this area.

According to our survey results, nearly one-third of banking executives believe change is always embraced at their institution and 44 percent say it is often embraced. The biggest barriers to change were identified as fear (38 percent), unclear benefits (32 percent) and turf protection attitudes (30 percent).

Q. Acceptance of innovation and change in my institution is:



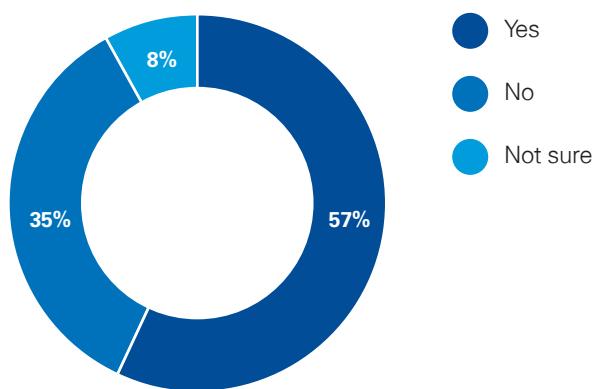
Empowering a chief innovator



But how do you successfully drive change and innovation throughout your organization without somebody steering it? According to our survey results, only 57 percent of banking executives said their bank had a Chief Innovation Officer position. This is a trend that must tick upward to help drive the change needed.

Consider the results of Bank Innovation's annual Innovators to Watch¹³ list. Only three out of the top 10 innovators on the list are from banks. Moreover, out of the 44 total innovators named on the list, just 14 are leaders from banks. The majority hail from fintechs and other technology companies. This signals a definite need for a C-Suite level champion of change that takes the lead on innovation within the banking organization.

Q. Does your bank have a Chief Innovation Officer position?



Key takeaway:

The business case for innovation in banking is clear. Yet, for many banks, the role of a chief innovation officer is still vacant. In today's marketplace, this is not really an optional role. After all who at the top is responsible for putting in place the right infrastructure and processes needed to foster innovation and enable progress across the enterprise? Who is spearheading the transformational strategic innovation that spans the entire business? Who has buy-in from the C-Suite and looks to incentivize the workforce on innovation initiatives? Who is driving the culture change that values creativity, encourages new thinking and explores different approaches?

¹³ 2015 Innovators to Watch: 44 Executives Shaping the Future of Banking, June 24, 2015, Banking Innovation.

Conclusion

Differentiation between banks is becoming more pronounced as they re-invent how they deliver services and create new customer experiences. We observe banks being more optimistic about their ability to grow revenue, which echoes their focus on customer connectivity and relationships. Larger banks are anticipating modest growth gains while showing signs of real progress delivering front-end digital capabilities and increasing customer satisfaction levels.

Across the spectrum, banks are relatively strong. New models are evolving and innovative approaches emerging. Yet, the strides are small. And the need for speed cannot be understated as a new banking landscape unfolds, bringing with it a continuous wave of new competitors.

Fundamentally, banks have to work harder to make their organizations more agile. The predictability, reliability, and trustworthiness of banking institutions have stood the test of time. However, seismic shifts in demographics, rapidly advancing technological change and intense competition in all areas of a bank's business are creating an entirely new banking landscape. And to effectively compete, banks need to do better and act faster.

This means solving the digitization puzzle they currently face. It requires completely reengineering business models around the customer, implementing core technology that is flexible and agile, and accepting change and embracing innovation in all areas of the business. When all the right pieces fit together to enable a truly digitized experience across all channels to combine with a bank's incredible network and ability to foster personalized relationships, banks will have a clear advantage.

Recently, Harvard Business Review created a speed index for leaders to find correlations between speed and perceived effectiveness. They found that "being good is only marginally better than being quick...both are necessary, and neither alone is sufficient, to be perceived as an exceptional leader today."¹⁴ In these times, speed and leadership are the crucial requirements for a bank to stay out in front.

¹⁴ Zenger, Jack and Joseph Folkman. You Have to Be Fast to Be Seen as a Great Leader. Harvard Business Review. 26 Feb. 2015.

To help accelerate progress, consider these key action steps:

- **Keep an intense focus on agility.** Achieving agility is paramount for banks. By doing so, banks will create the ability to dynamically adapt to change as it happens, leverage technology innovation to create new business models, and strive for continuous improvement in meeting the evolving needs of customers.
- **Instill a culture that embraces change.** A culture shift in banking is long overdue. As an organization, banks need to develop a more collaborative approach to help drive change. This includes management involving more business units and connecting more people together to share and introduce new ideas, implement new processes, and help dismantle existing operational silos. Create an atmosphere that encourages a ‘fail often, fail fast, learn safely’ culture with appropriate incentives and metrics.
- **Encourage innovation and make it part of your DNA.** Realize the value of innovation and encourage creativity and new approaches to achieve goals. Create multi-functional working teams to brainstorm and share ideas to drive collaboration. Create incentives and reward areas that practice innovation and embrace change to encourage progress. Assign a chief innovation officer, who has the support of the entire C-suite, and provide the appropriate amount of facilitation, engagement, support, resources and personnel needed to expand innovation initiatives across all levels of the organization.
- **Create a core IT plan and stick with it.** Don’t ignore your legacy IT issue any longer. Moving forward with digital requires more than a patchwork of systems cobbled together. It’s time to remove the data silos that exist throughout your organization. Regardless of whether you plan a core system overhaul, phased upgrades, middleware or equivalent solutions, it’s time to integrate your systems with modern technology. Determine the optimal core environment that you can achieve and then go for it.

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