

Accenture Banking

Top 10 Trends for 2023

The gravity of rising rates



Foreword

The five key forces of change

1 Total Enterprise Reinvention

Companies are making the strategic decision to continuously reinvent themselves by digitally transforming every part of their business with technology, data, automation and AI. They are breaking down internal silos and connecting functions and data across the value chain—creating new ways of operating and serving customers and their people, and discovering new business models and growth opportunities. With this strategy, banks can set a new performance frontier for themselves—and for the industry.

2 Talent

Leading banks are creating stronger workforces with a three-pronged strategy: they access talent, inside and outside the organization; unlock the potential of existing talent with technology and by developing their skills; and create new talent by looking at people's potential beyond their current skills.

3 Sustainability

Sustainability spans environmental, social, and governance (ESG) issues—from transitioning to a zero-carbon economy to human rights, and beyond to inclusion and diversity. When companies and governments embed sustainability into their operations, they can create real value and make a difference.

4 The Metaverse Continuum

This is a fast-evolving spectrum of digitally-enhanced worlds, realities and business models—stretching from a digital layer on reality to completely virtual environments that offers every enterprise opportunities for change and growth. Banks should start to create a strategy now to realize the business potential of the metaverse continuum tomorrow.

5 The Ongoing Technology Revolution

New technologies and expanding IT are disrupting all aspects of business, driving the next waves of innovation that are bringing new approaches and solutions to businesses in every industry. Banks should prepare themselves to harness these new forms of technology and computing for competitive advantage.

These five key forces of change are manifest in the ten trends which we believe will have a profound influence on banking in 2023 and are likely to continue to shape and drive the industry for many years to come.

Introduction

Low rates – banking's Big Bang

Forces of change are reshaping banking. The last time the banking industry experienced steeply rising rates off a very low base was back in 2005—before the launch of the iPhone, which seems like an eon ago.

Over the past 17 years low rates have had the effect of a Big Bang, shattering the fundamental equation of banking (deposits drive lending power), severing the connections between related offerings, and dramatically disrupting valuations and markets.

The gravity of rising rates

Lenin said there are decades when nothing happens, and there are weeks when decades happen. This year is likely to be one of those weeks. Banks are having to manage not only macro-economic and geopolitical change, but also profound, longer-lasting shifts that are driven by technological innovation. At Accenture we believe these shifts are an opportunity for banks to reimagine and reposition themselves for the future. We call them the five key forces of change. They are reshaping industries, breaking down barriers to entry, and blurring industry lines. They also provide much of the energy behind the trends that are affecting banking in 2023.

Banking returns to its regular orbit

For many years, low and even negative rates meant money was effectively free—and worth very little to banks. A deposit balance of \$25,000 is worth \$720 a year in income when the rate is 3.75%; when it's 0.25% it earns only \$29 a year.¹

Until the financial crisis of 2008/9, interest rates were the gravitational force that kept banking's integrated deposit/lending model working dependably. Without this gravity, powerful distortions shook the industry. Banks were deprived of a major source of revenue, causing them to shift their focus from the totality of customers' financial needs to isolated products that continued to generate fees. This in turn strengthened the product silos within most banks.

At the same time, the fintech universe exploded. A multitude of brilliant innovators with sky-high valuations burst onto the scene, awash with cheap capital and prioritizing scale over financial returns. Ignoring time-honored business models, they targeted only particular parts of the value chain. The result was an eruption of innovation and competition.

The customer experience was impacted profoundly. Consumers wanting to take advantage of the new value that was being created had to expand their portfolio of financial service providers and construct their financial journey using a mix-and-match of the best products drawn from the various silos.

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Most of the trends shaping banking in 2023 are affected, if not actually caused, by the return of positive interest rates—the gravity that keeps the industry in a predictable orbit.”



Michael Abbott
Senior Managing Director
– Global Banking Lead

Some players took things to the extreme, creating money from nothing: minting crypto coins and NFTs. The value was in the eye of the beholder—until it wasn't.

Most of the trends shaping banking in 2023 are affected, if not actually caused, by the return of positive interest rates. Gravity has been restored, and the constellation of banking products are drifting into a more familiar and predictable orbit. Deposit accounts are once again fueling the industry and balance sheets suddenly matter again.

The year ahead won't be without its surprises and disruption; it definitely won't be boring. The revival of interest rates may not herald a return to business as usual, but it will certainly be welcomed by most banks.

Harnessing change

Leading banks recognize they need to accelerate change—not only to compete but to find new paths to growth. The five key forces of change which Accenture has identified as having the greatest impact on the transformation of organizations and business as a whole are gaining momentum. For C-suites looking to forge ahead, these forces are showing the way.



Rising rates catalyze product innovation

The low, static interest rates that have dominated global macroeconomics for the past decade and a half may have been appreciated by businesses and homeowners, but the benefits for banks have been limited. Deposits generated little profit and depositors either received minimal interest or even had to pay to keep their money in the bank.

The absence of interest rate competition caused banking's drawbridge to come clattering down, allowing a flood of digital-only banks to rush in. It also caused banks to shift most of their attention to those products that were still generating revenue. In the process, however, they became less customer-centric, more siloed and less innovative. All of these made it more difficult for banks to drive total enterprise reinvention.

For banks that have spent many years adapting to a zero-gravity environment in which many of the industry's natural laws seemed to have lost their influence, the return to earth will be welcomed. What, in practical terms, does it mean for banks in 2023?

While most deposit-taking institutions will benefit from the increase in rates, all deposits are not created equal. The big prize in the current environment is sticky deposits with the lowest possible deposit beta*. Stickiness used to be easy to achieve, but in recent years many of the barriers to switching have been weakened by technology. Digital banking has eliminated the personal connection. Comparison sites like Bankrate in the US, MoneySuperMarket in the UK and BankBazaar in India make it easy for customers to move their money in pursuit of the best rates. Customer inertia is no longer enough to ensure retention.

**Deposit beta is the portion of a change in the prevailing interest rate which a bank passes on to its customers. It is a measure of the sensitivity of deposit pricing to monetary policy benchmark rates.*

For these reasons, rising interest rates will be the rocket fuel that ignites banks' product innovation. Banks will quickly scrap their product silos and redirect their focus to the totality of their customers' financial needs. Innovation will come in the form of offerings similar to that of Amazon Prime: a personalized, integrated set of products and services that deliver a value proposition amplified by a multiplier effect.

These innovative offerings are likely to erode silos and draw on both sides of the balance sheet. One example is Bank of America, which uses intelligence to wrap a tailored collection of deposit and credit products around the customer and then offers an integrated loyalty program that recognizes the total value of each customer. Both parties benefit, with the bank reporting close to a 99% retention rate.² Discovery Bank in South Africa helps customers manage their finances, tracks their progress and rewards those who do well with a wide range of offers, from discounts on healthy food purchases to reductions on airfares and holiday accommodation.³

This is just the start. Like Amazon and other bigtechs, banks are likely to continually add features and new capabilities that scale as the customer relationship deepens: the more you use, the more you get. We expect the innovators to be more creative—perhaps, instead of a toaster for opening a new bank account, customers will get a discounted Netflix subscription.

High rates will radically change competitive strategies in 2023. Expect the heat to be turned up on hot money deposits (the kind that are most likely to move in search of better returns). Certainly, the most dangerous place for a bank to be in 2023 will be at the top of Bankrate's list of competing deposit-takers. Expect to see a surge of M&A in the months ahead, with the most innovative banks that enjoy the most stable deposits snapping up their hot-deposit counterparts.

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The banks that are likely to succeed over the next year and beyond will be those that bring their siloed products back into an integrated offering, fueled by deposits, that powers greater benefits by addressing the totality of each customer's needs.”

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The renaissance of the branch

Prior to the pandemic, few banks spent time wondering whether their branch network was a blessing or a curse—it was simply an unavoidable part of doing business. Then the unthinkable happened and virtually all branches were shut. Today, most banks are asking: what is the future of the branch?

In 2019, banks worldwide spent more than \$650 billion maintaining their branch network.⁴ By our analysis, in the markets that account for roughly three-quarters of global GDP, this translated to about 84 basis points of the average deposit held in 2019 by banks in these markets. Reducing the geographic footprint and encouraging customers to use only the bank's digital channels had obvious cost benefits.

However, it came at the expense of personal relationships and a deeper understanding of the customer's needs and intent. In an environment where deposits have value to the bank and where some customers still believe their money resides in their local branch, these relationships matter. Treating customers holistically, individually and intimately can make a huge difference—we believe the value, in terms of creating loyalty and easing the need to compete on price, is significantly greater than the cost.

The pandemic showed us that without face-to-face interaction, most banks struggle to maintain close, loyal relationships. Digitalization made customers more self-reliant, but at the same time it eroded banks' differentiation, facilitated switching and generally made banking a lot less personal—the opposite of what is needed to succeed today.

The year ahead will see a renewed focus on branches. Many banks will follow the lead of JPMorgan Chase, which 18 months ago reported it was more than halfway through its 2018 plan to open 400 branches in new markets across the US by the end of 2022.⁵

Banks will be inviting customers back and welcoming them home. More importantly, they will be shifting their emphasis from meeting specific needs and selling individual products to talking about improving customers' general financial wellbeing. Banks will use their branches to learn more about their customers, show interest and empathy, offer advice and build loyalty.

This won't be a pivot away from digitalization; rather, a horses-for-courses approach that recognizes the strengths of each channel. Customers today do most of their banking on their mobile devices, with only 3% of interactions happening face-to-face. However, an in-person meeting remains the preferred option when opening new products—27% of consumers said it was their first choice, ahead of mobile apps (22%) and websites (21%).⁶

The opportunity is to move beyond a marketplace where the value of a customer is equal to the sum of the products they use, to one where a multiplier effect is at work. This is where the branch comes into its own, but it will take a retrained and re-oriented workforce that is motivated, engaged and feels appreciated. It will also take a more tailored and purposeful customer journey than we saw before the pandemic. This journey will, in many cases, include non-financial products that help customers deal with challenges in areas like housing, mobility, e-commerce and more.

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Branches allow banks to offer lower deposit betas without seeing their customer bases taken over by comparison sites. However, achieving the right balance will demand a fresh look at where the branch fits into the bank's overall customer experience.”

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The metaverse demystifies

In 2023 the metaverse will not completely transform the banking industry. What will happen, however, is the metaverse will continue to mature. More banks will shift it higher up on their agenda, from a social and technological curiosity to a serious opportunity that warrants careful examination.

The metaverse is not new, but it is still obscure and difficult for many to get their heads around. While it is one of the five key forces driving change across all industries, banks have yet to come up with a definitive answer to the obvious question: how can we make money from it? Yet if the estimates are to be believed—some analysts have projected that the total addressable market will grow to \$8 trillion in as little as the next eight years—then the opportunity is simply too big to ignore.⁷

It's significant that the natural evolution of the metaverse as a banking channel is following a similar playbook to banks' move online and their adoption of mobile. However, it's happening much faster. Many are still skeptical, but when mobile burst onto the scene, few thought it would be feasible to shrink banks' online experiences into a space little bigger than the palm of their hand.

Just as mobile did, so the metaverse is opening a new world of possibilities. We believe most banks will approach the opportunity with a four-step strategy: enable, engage, invent and imagine.

- At its most basic level, the metaverse **enables** banks to interact with their employees and customers in an infinitely richer environment. Just imagine a simulation where a branch team is totally immersed in responding to a bank robbery as it happens—there is no comparison between that and using conventional training media.
- The metaverse may be our best opportunity to put humanity back into banking. What if you could **engage** in a VR conversation with a customer in their living room,

as Kookmin Bank does? Or show customers how they can adopt sustainability in all aspects of their lives, including their finances, as DBS's LiveBetter does? Or use gamified experiences to help young customers improve their financial literacy, as Ally Bank does with its Fintropolis? The potential is limitless.

- We cannot be certain how this new channel will evolve in the years to come or how it will **reinvent** banking, but few are disputing that the change will be rapid and far-reaching. This will be especially true for payments—not how we pay, but rather how we *get paid*. Trusted standards for acceptance will need to emerge and the form and method of payments will change: will we use a card to pay in the metaverse or will we AirDrop money to each other? These questions will receive a lot of attention from bankers in the next 12 months—47% of them believe customers will use AR/VR as an alternative payments channel by 2030.⁸
- Banking in the metaverse will deliver value. It's hard to **imagine** everything it will encompass and it's still a way off, but the trajectory is emerging. The rapper Snoop Dogg bought land and built a virtual mansion on the Sandbox platform, after which a fan bought a neighboring plot for around \$450,000.⁹ The question for bankers is: would you lend that \$450,000? Would you insure the property? The revenue streams could be substantial, and with 400 million active monthly users¹⁰ and over 20 banks¹¹ having already set up on the metaverse, someone is sure to grab the opportunity.

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The metaverse will be one of the biggest trends in banking for years to come. It won't be without risk—the legal and reputational pitfalls are certainly significant. But banks were invented to manage risk. So be curious, be bold and find out what this watershed technology has to offer.”



Right culture, right talent

Banks' monolithic cultures have been shaken and exposed by recent events. The pandemic and the accompanying work-from-home upheaval did a lot more than dramatically accelerate banks' technological transformation and eliminate employees' commute. It also transformed how work is performed and managed, employees' levels of autonomy, their expectations regarding flexibility and a work-life balance, and the sourcing of talent. Taken together, these pose an unprecedented challenge to leadership and the status quo.

Many of the positive changes that employees experienced as a result of the pandemic sit uneasily within banks' current culture. Their rigid, siloed structures are straining as employees increasingly want to work within fluid, transient teams, acquiring new skills and making frequent changes to their career paths.

What's more, banks' ambitions are being stunted by the difficulty of attracting and retaining the people they need. A global survey revealed in 2021 that more than 40% of employees were thinking of leaving their current jobs.¹² Another found that financial services workers are more ambivalent (29% vs. 12%) and less optimistic (24% vs 42%) than the global workforce as a whole.¹³ And a third study showed that only 10% of Gen Z and Millennials are interested in a career in financial services.¹⁴

While these issues apply across the business, they are especially pertinent when it comes to priority workforces that make a difference to the bank's performance. Revenue-generating roles such as wealth and corporate relationship management are obvious candidates for special attention, while sustainable finance is already experiencing red-hot demand.

Many banks have responded by striving to do the familiar things better. This is unlikely to work. The ongoing digitalization of banks has shifted the balance of their skills profile by automating many routine clerical tasks and at the same time creating new roles requiring scarce specialist skills.

While we are seeing many banks reducing the size of their workforce, they are also increasing the average cost of their employees. Their people are becoming more demanding, less accepting—and more likely to leave.

This altered environment calls for a new mindset and a different approach. In the year ahead we expect to see more banks changing their talent strategy: acknowledging the realities of the employment market and taking a more deliberate approach to aligning talent with the demands of the business strategy.

Successful employers will have a detailed workforce plan that changes the size, cost and skills of their workforce, and they will join up their strategies for sourcing, selection, mobility, development and retention. They will rethink their traditional vertical job hierarchies and experiment with cross-functional teams in which skills are pre-eminent. They will design fluid organizational models that support movement and progression, agile ways of working and seamless collaboration across silos.

They will also take a fresh look at their talent costs, which are too high and too fixed. Addressing this within their existing work model has, over time, yielded diminishing returns; the alternative is to transform what work gets done and how. A growing number of banks, which in the past might have variabilized their manual-intensive functions by taking advantage of cost arbitrage, are now more likely to offload work that will simply go away over time. By acting now to get ahead of the inevitable, they can focus instead on strategic work.

The bank's technology strategy will, of course, be an increasingly important input to this plan. Banks would be a lot more effective at this if their leadership teams were more familiar with technology and the opportunities it brings—our 2021 survey found only 10% of banks' directors had professional experience in technology.¹⁵ Banks would also benefit from appointing chief transformation officers and other business-oriented technologists who ask, about digitalization, not just 'how' but 'why'.

Talent—one of the five key forces of change which banks can harness to unlock their full potential—will make ever-increasing demands on banks' leadership in the months and years ahead. If it isn't given the priority it deserves, it will quickly assert itself as a burning platform.

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The pandemic has forever changed employees' expectations. Banking's leadership and cultures need to catch up to the new demands of a more mobile, in-demand talent pool.”



Risk everywhere

When it became apparent that the pandemic was likely to hit their customers hard, banks globally set aside an estimated total of \$834 billion in anticipation of a wave of credit losses.¹⁶ Toward the end of last year, despite having come through the pandemic relatively unscathed and in the midst of low global unemployment, they again made provision for an increase in delinquencies—by the end of September they had already set aside \$318 billion, 9% more than the same time the previous year.¹⁷ Clearly, banks believe risk is back.

The world has been confronted with geopolitical and climatic instability, energy shortages and a spike in inflation. Globalization is becoming increasingly unfashionable as governments shift their focus to protect national interests. The war in Ukraine is seeing many more people, across a wide front, gaining experience in the dark arts of cyber intrusion. Crypto has crashed. With rising rates and an impending recession, analysts are once again predicting that delinquencies will soar and put stress on banks' balance sheets.

Until now, banks relied on the truism that a rise in unemployment drives delinquencies and, ultimately, losses. Their response has been to turn to their collections departments, which are wired to 'dial for dollars.' This time, with gravity returning to markets and the distortion of zero rates easing, things will be different.

- Homeowners in markets dominated by short-duration mortgages could face the prospect of their payments doubling. Political pressure will force many governments and central banks to look to their Covid playbooks to stabilize their markets. Banks will once again be expected to think differently and innovate quickly to prevent fire sales and perhaps even social unrest.
- In commercial real estate, Covid drove down utilization in many of the bigger markets from as much as 95% to below 50%.¹⁸ When the loans on these properties come due the risk assessment by banks and borrowers alike will be quite different than before, with opportunities like the conversion of unused business premises into residential units being considered.

- The drivers of auto financing are changing in similar ways, with affordability, embedded finance, subscription models and other trends combining to change both the level and nature of risk. As consumers tighten their budgets, expect them to arbitrage their options.
- The warnings that accompanied the launch of buy now, pay later at first seemed to be overstated. However, in 2022 it was reported that while the UK market had more than doubled in 12 months to £5.7 billion (US\$6.7 billion), almost one in four BNPL users (and 35% of those aged 18-34) had failed to pay their installments on time.¹⁹ As inflation continues to choke household budgets, the collapse of these unsecured shadow lending markets cannot be dismissed.

These new risks and challenges are forcing risk leaders to determine—at high speed—what the likely impact is on the bank's strategy and operations. They need to take a more holistic, forward-looking scenario approach to identify which risks should be prioritized, what the appropriate responses are and what investments make sense right now.

Banks, and the risk function in particular, will need to continue to evolve. In most cases today, the risk dimension is considered at the end of a process review. In the future, it will need to be an important input in the early stages when decisions are made about business and operating models, organizational structure, product design, data, talent and other critical issues.

Looking specifically at the growing risk of loan defaults, banks that have honed their digital capabilities will be much better equipped to help their customers manage their financial obligations. This is when their investments in a superior customer experience, in behavioral economics and design-led thinking, and in digital collections will truly pay off.

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Banks that focus on helping customers solve their problems, rather than getting collections to 'dial for dollars', will significantly outperform their peers—not only by minimizing losses, but by strengthening their long-term relationships with valuable but distressed clients.”



Data becomes a product

The abundance of data has led banks to imagine a glorious future where insight-driven decisions could be made in real-time, customers could be understood in unprecedented detail, and products and services could be personalized to game-changing effect. But so far, most banks have been unsuccessful in using data and core technologies like cloud and AI to drive innovations that would make them more relevant to their customers.

Data lakes and central data teams were created to facilitate insight-driven decisions, yet in many cases they have become bottlenecks choking the flow of insights to the business. The demands of maintaining the data and its repositories leave most data teams little bandwidth to respond to the business's data requests. More importantly, banks' data is often siloed by line of business, by function and by channel. This not only makes data management more complex and costly, it also causes redundancy and risk and inhibits sharing and collaboration.

The first step to overcoming these problems in 2023 is a shift in mindset: data needs to be regarded as the oxygen that fuels the bank's every action, rather than its CO₂ that accumulates as an inevitable by-product of its actions. The value to the bank and its customers should be recognized and it should be treated the same as a product. There should be product owners whose job is to identify and define the use cases, clean the data, and set up the APIs and structures that allow different teams and systems from all parts of the bank to access it. These product owners should promote the data and help the business to use it as effectively as possible. It's not going too far to say they should be incentivized to help the bank meet data-usage targets.

This is where the data mesh comes into its own. A data mesh is not a new tech product—it's a change in mindset, approach and structure. It has the potential to be, to data, what agile was to our ways of working. It starts with a business use case, which might be the identification of fraud or commercial loan underwriting. Based on the

use case, a data product owner assembles the relevant data from all its disparate locations into an organized product, making it easily accessible by means of APIs. Just as any other bank product owner does, the data product owner then works with the business users—data scientists, business analysts, operations, external partners and more—to help realize the business value.

JPMorgan Chase created a data mesh to improve its fraud detection. It appointed a data product owner who pulled data from debit and credit card usage, check spending and other sources into a data product that allowed the bank to reduce fraud costs without compromising data governance.²⁰

In a true data mesh the data is all connected, even if it is located in silos across the bank. What it does is create a marketplace for producers and consumers that democratizes data and allows users to analyze cross-domain data on their own, rather than putting their analysis request into the queue for the central data team to process. This in turn helps them create business value while driving down costs. By providing a single view of all data it helps eliminate redundancies, simplifies data governance and promotes re-useability.

In 2023 we will be hearing a lot more about this new approach. Although data mesh has become a buzzword whose definition is murky, the power of data as a product is clear. The real opportunity will be in finding the right data products to radically change business outcomes.

Consider commercial banking. Today, commercial banks collect vast amounts of data from each customer—

income statements, balance sheets, legal information, ownership data, ESG reports, to name a few—and store it in different places all over the organization. Whenever the customer applies for a new product, from a different division, the bank asks for this information all over again. The real opportunity, for banks that organize their data as a product, is to collect the information once and then use it repeatedly. New commercial loans could be offered in hours, rather than days or weeks. Customer insights could be unlocked to proactively sell new products and AI could help relationship managers in real time to dramatically improve customer interactions.

Data mesh, together with data product owners, is not the solution to all data problems. Yet it could allow banks to unlock the value trapped in monolithic data lakes and data silos—and to fundamentally change the way banking is done.

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Data, when treated as a product, has the potential to transform the foundations of banking. Banks don't lack data, they lack the means to unlock it, and simply and consistently turn it into actions. Having a data product manager and mindset could be the key to unlocking the value trapped in data—value that every bank knows it has.”



Fintechs: from disruptors to enablers

The golden era of fintechs and digital-only banks is losing much of its luster. After years of sky-high valuations and a seemingly limitless flow of capital investment, the tide has now turned—to the benefit of incumbent banks especially.

The market capitalization of public fintechs fell by 36% between the end of 2021 and October 2022.²¹ Klarna—until July 2022 the highest-valued European fintech at \$45.6 billion—has lost 85% of its valuation, dropping to \$6.7 billion.²²

The number and value of fintech deals has also declined. In Q3 2022, private company financings, IPOs and acquisitions worldwide fell 73% from their peak in Q3 2021.²³ Venture capitalists in particular have cooled to fintechs: the number and value of mega rounds in Q3 2022 was the lowest since Q2 2018.²⁴

There are several reasons for this turn in the tide, one of the most important being the rise in the cost of money. Digital-only banks have survived until now on the very fringes of profitability, often kept in the game only by repeated rounds of VC investment. These are now harder to come by. This will not only dampen the disruptive impact of existing fintechs but also likely reduce the number of new start-ups making their appearance. What's more, the volatility of this sector may make it less attractive to employees for whom job security has suddenly become a concern.

All of this is significantly changing the competitive environment. The hunter is becoming the hunted as fintechs become ripe to be acquired by banks that are eager to take over a particular technology

or group of innovators. Other interested parties will be the bigger banking technology providers looking for bargains, and bigtechs looking for a way over the barriers to entry that until now have protected traditional financial services companies. However, even bigtechs have become less aggressive.

Some notable recent deals are Lloyds' acquisition of the digital insurer Cavendish Online,²⁵ HDFC Bank's investment in the Indian payments fintech Mintoak,²⁶ and BNP Paribas' purchase of Kantox, a fintech that automates currency risk management.²⁷

While fintechs may become less of a direct threat, banks should not become complacent. The start-ups will continue to innovate, and as industry enablers will empower traditional competitors to enhance their offerings. These banks are likely to use their newly acquired experiences and capabilities to compete in the void left by the fintechs and to aggressively grow their market share and revenue.

The trend we've seen towards 'co-opetition' between banks and fintechs is likely to continue among well-established providers but may be very different for smaller players. Banks, if they're smart and aggressive, will have the opportunity to retake share in markets like credit, offering unsecured lending to consumers and small businesses.

Banks should also be able to reassert themselves as the 'rightful owners of banking' by catching up with fintechs in the delivery of customer service, experiences and value. But to do this they will need to develop or acquire market advantages and new technologies at reasonable prices and use these to enter new markets or expand their offerings.

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As valuations come back into orbit and fintechs become enablers or the targets of acquisitions, banks should seize this opportunity to develop or acquire a competitive advantage at a reasonable price, and use it to enter new markets or expand their offerings.”



Green gets real: the search for common ground

As the rhetoric around climate change intensifies, banks are under growing pressure—by regulators as well as the gamut of their stakeholders—to play a constructive role in reducing greenhouse gas emissions. They are expected not only to become carbon neutral in their own right, but also to help—and if necessary, cajole—their customers to transition to net zero. If these companies cannot or are reluctant to shrink their carbon footprint, banks will increasingly be expected to impose a risk premium or basically a higher cost of lending. Small wonder that sustainability is one of the five key forces of change driving transformation in banking and beyond.

Most banks have responded positively to their role in reducing greenhouse gas emissions. Many joined the Glasgow Financial Alliance for Net Zero after COP26 in 2021, and a recent Accenture survey found that nearly 60% of the world's leading banks have committed to net zero and want to become stewards of the global transition to a net zero economy.²⁸

The problem is that banks are not designed to take on the full spectrum of risk that such a global transition entails. Their fundamental job is to use customers' deposits *prudently*, lending the capital that powers the economy. Yet the transition to a net zero economy is a profoundly uncertain undertaking that teems with the sort of risks they would normally be expected to avoid.

A more realistic approach to financing a green economy would be to look beyond banking—to an ambitious public-private partnership. This would include venture capital and private equity firms, which have bigger risk appetites as well as the mandates and resources to take bets on relatively unproven technologies that will fuel a sustainable future. Governments and regulators would be included, facilitating and incentivizing their partners.

Currently, only 12% of large banks are on track to meet their targets for their own as well as their financed emissions.²⁹ Even if the biggest risks were to be taken on by the VC sector, banks that wanted to participate effectively would need to make significant changes to their culture, operating practices and incentive systems. They would need to educate and train their relationship managers to understand their

customers' carbon challenges a lot better and become adept at identifying their individual pathways to net zero. And they would need to source and analyze accurate, consistent data to measure the risk that each customer represents and to track its progress in reducing emissions.

The war in Ukraine has made it even more difficult for banks to live up to their commitments. The energy crisis caused politicians around the world to reconsider their condemnation of fossil-based fuels. Many have resumed or ramped up exploration for gas reserves, coal is making a comeback and Europe is exploring new investments in gas infrastructure.

The lack of clear leadership is also evident within banks themselves. Our research found that most leaders are committed to their bank's climate goals but have not succeeded in embedding this across the organization. Many still incentivize the granting of loans to heavy carbon emitters, which leaves relationship managers asking how they are supposed to act. Employees notice the lack of investment in the required new skills and question the firmness of their employer's commitment.

We believe consensus will be a priority in 2023. Politicians, regulators, activists and everyone else involved will seek common ground and a realistic approach to achieving net zero. We expect transition finance to become the focus, with meaningful conversations being held around public/private partnerships. We also expect green hype to give way to a clearer, more realistic allocation of roles and actions.

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Sustainability is on the agenda of almost all banks' board meetings and is mentioned in all their annual reports. But not enough is happening. There's no doubt banks have a major role to play, but they can't do it on their own. Governments and regulators will play critical roles too.”



Life centricity: from journeys to intent

For years now, service providers have focused their attention on the customer experience. The customer journey has been a big part of that, and some firms have gone so far as to organize themselves around these journeys. Digitalization has helped deliver speed, simplicity and convenience, while data and analytics have enabled companies to better understand their customers and to personalize their offerings. Banks, especially during the pandemic, have been at the forefront of this trend.

The benefits of digitalization have been huge, but they came with disadvantages. Banks perfected mobile and remote banking, but in the process the customer journey became functionally correct and emotionally devoid. With 97% of today's banking touchpoints occurring remotely, banks themselves have become more remote.³⁰ The loss of a human connection has eroded trust, removed a vital barrier to switching and sharpened the competitive focus on price.

It's no coincidence that so many banks want to get into wealth management—they are eagerly seeking any emotional engagement that trumps price. For example Fifth Third Bank, a regional US bank, has launched an independent wealth advisory firm in the hope of recruiting users of its standard banking products as clients.³¹

Bigtechs and super-apps are among those who seem to have got it right: they have moved beyond a journey mindset to understanding and addressing the customer's intent. This is similar to the evolution of GPS route-planning systems. Early systems, when given a destination, considered only the obvious routes and directed all their users along these roads. Today, Google Maps (among others) has a lot more information and is a lot more thoughtful. It factors in weather conditions, traffic congestion and roadworks, which might send motorists on surprising detours—because it has a better idea of their intent and how best to satisfy it.

By knowing what matters most to a customer at any particular time, and by combining technology with people skilled in nurturing holistic customer

relationships, banks will be able to optimize the experience for that moment—and achieve unique and productive connections.

The year ahead will see the continued growth of bigtechs and super-apps, all of which are likely to continue to syphon off banks' traditional revenues by embedding financial services within their platforms and offerings. Banks' best defense will be to take a page from their competitors' playbooks: widen their aperture and focus on their customers, not only as consumers of specific banking products but as complex, multifaceted human beings who are doing their best to adapt to circumstances beyond their control. We call this the shift from customer centricity to life centricity.

In practice this starts with data, which needs to be organized around the customer rather than the bank's products or channels (see *Data becomes a product* on page 16). Think of multiple data lakes of one, each unique to a particular customer. In many ways this emulates what great branch managers have always done: keep track of who their customers are, what they want, where they are going in life and what they are likely to need next. They listen, remember, learn and act on this knowledge—often proactively.

All this data, collected from a wide variety of sources, is mined in real time and analyzed by artificial intelligence to identify intent. Again, this is what great branch managers did in the past; now you can do it consistently, at scale, by buying a cognitive engine—like Google's Dialogue Flow—with a credit card.

The growth to dominance of the bigtechs and super-apps, and the standards they set, pose difficult questions for banks. Few relish the prospect of becoming a utility or competing with the giants on their own terms. For these banks, the best option is to strengthen their franchise within their customer base. This means gaining a better understanding of their customers, delivering a constantly improving experience, and demonstrating authentic empathy and purpose.

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In 2023 banks will begin the move from thinking about customers' journeys to their intents. We call this life centricity, and it will better equip banks to understand the different forces shaping customers' lives and to deliver the most relevant solutions for their individual contexts. Banks that embrace this approach will be strongly positioned to thrive alongside their customers.”



10

Core modernization: a change of heart

Banks have long felt the pressure to modernize their core processing systems—and those that want to totally reinvent their enterprise need a strong digital core to thrive in a future where technology is a primary source of competitive advantage. This is critical to leverage the power of cloud, data and AI through an interconnected set of systems across the enterprise that allows for the rapid development of new capabilities. But for reasons that have been discussed over and over through the years, most banks have delayed the move. In 2023, a confluence of factors is driving many banks around the world to reconsider their core systems, which are often 30-40 years old. Our recent survey of almost 100 top banks shows 63% are either in the process of moving their core systems to the cloud or getting ready to do so.³²

What's finally driving this change of heart?

- **Rising rates that help solve the affordability challenge.** Replacing a core is not cheap but in 2023, as interest rates restore one of banking's significant revenue streams, affordability will become less of an obstacle. Many banks will opt to invest this windfall in their future.
- **The demand for product innovation at speed.** We expect to see more cross-product innovation along the lines of Amazon Prime, with banks creating integrated product sets that offer greater rewards to customers who accept more of the products. Offerings like these put a strain on old systems designed for products rather than customers, and for batch processing rather than real-time payments.
- **Fear of being left behind.** There was safety in numbers as long as everyone held off. Yet, as Stephen Greer of Celent wrote after JPMorgan Chase announced it was moving its retail banking systems to Thought Machine's Vault platform on the cloud: "No bank wants to wake up one day and realize it's still running a COBOL platform on-prem while its biggest competitor is 100% cloud-native."³³
- **The aging of banks' mainframe support teams.** Over the years banks worked hard to customize their cores to support a plethora of new features and functionality. In the process, however, their core code looked increasingly like a bowl of spaghetti—and the only people who know how to untangle it are rapidly retiring. For these banks the choice is stark: upgrade or invest in more COBOL training.

- **Regulatory pressure.** Over the years, banks bolted new regulations onto their legacy code, manually and repeatedly. As a consequence, their risk and regulatory compliance is only as strong as the weakest link in their core. Regulators have taken note and made it clear: fix the fundamentals in your core or we will eventually merge you into a bank that has done so.³⁴
- **No need for a Big Bang.** The likely disruption caused by a multi-year transformation was always a good excuse for sticking with your mainframe. However, today's cloud-native platforms not only dramatically reduce the timeline; they also allow migration and the launch of new products to be done progressively, which reduces the risk. The ROI has improved dramatically.

Tech modernization is of course a 'forever' process, but for the reasons above we believe 2023 will be the watershed for the start of core modernization. The balance of pros and cons has been shifting for years; this is when we reach the tipping point.

Many will protest: "But we *are* modernizing our core systems!" The standard approach has been to incrementally improve them in bits and pieces by leveraging new middle-office and front-end platforms. Yet the benefits have been marginal as this effort has failed to address the heart of the problem. It has become clear now that the only acceptable approach will be one that enables not only efficiency, flexibility and security, but also hyper-personalization, transparency, product innovation and real-time processing.

The next 12 months will be a great opportunity for banks to invest in the future and become reinventors. This will be the year when they show they can be innovative and fleet of foot and are committed to delivering a competitive experience for their customers.

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With the windfall from rising rates, many banks will use 2023 to start tackling their legacy environments and creating modern banking operating systems for the next decades. The ones that solve this challenge will be incredibly well positioned to grow, consolidate and—most importantly—deliver exceptional, innovative products more efficiently than their competitors.”

Conclusion

A time for new hope

The rise of interest rates in 2023 will restore the logic of banking and reimpose the gravity that has underpinned its 'normality' since the dawn of the industry. Deposits will regain their value and deliver a windfall to virtually all banks. At the same time, higher rates will stress lending markets and expose distortions that for years have lain hidden in the industry. The year will certainly not be without its risks.

Not all banks will use their increased profits in the same way. Many will simply pass it on to their shareholders in the form of dividends or stock buybacks. Others will see it as an opportunity to become reinventors by confronting the new emerging risks, building their digital core, creating stronger workforces, and laying the foundation for greater, more sustainable returns. By harnessing the five key forces of change, banks have an opportunity to combine the best of what we witnessed in the rise of neobanking with their traditional strengths to create a bright new future.

There is no right or wrong answer—every bank faces a unique set of demands and pressures. But given the daunting challenges they face, the decisions made in the year ahead are likely to be critical. What all banks do have in common is a growing need to address change more rapidly than before, and where possible, simultaneously instead of sequentially. This compressed transformation will test the mettle of all organizations, their leaders and their workforces.

Given the far-reaching import of the trends that we've described, each bank's decisions will set it on a course that will shape its destiny for years to come. Careful contemplation, wisdom and decisive action will surely be the differentiators that allow the leaders of tomorrow to claim the future.

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