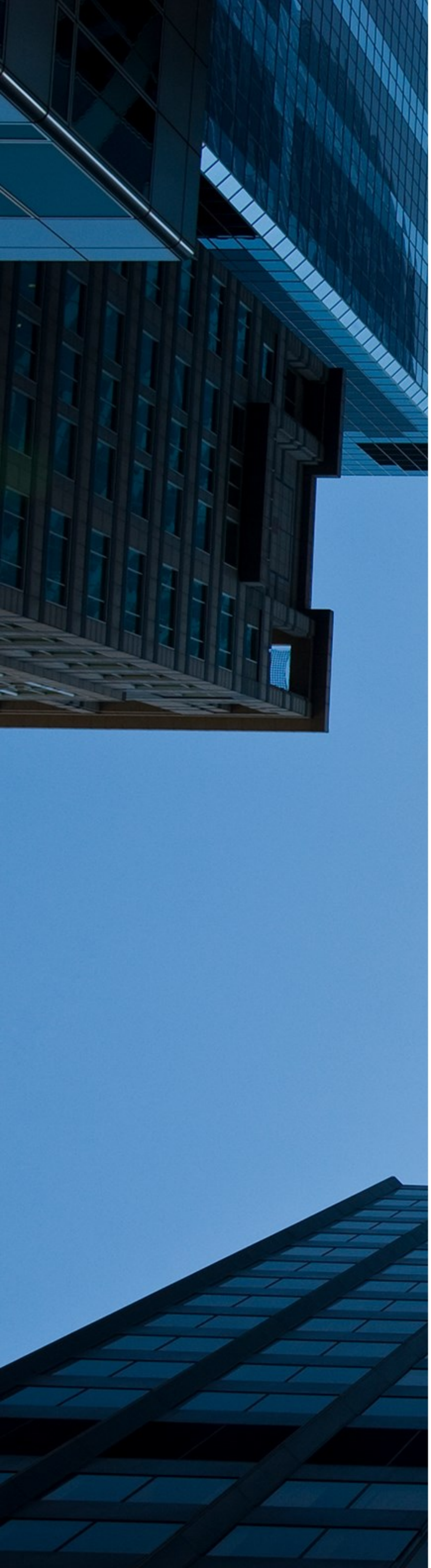

Aite Novarica

AUGUST 2022

EIGHT KEY TRENDS IMPACTING THE RETAIL BANKING INDUSTRY

WHAT SHOULD KEEP BANKERS UP AT NIGHT

PREPARED FOR:

Hyland

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AUGUST 2022

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EXECUTIVE SUMMARY

The economy is entering uncharted waters that will present new and unique challenges for financial institutions (FIs). The leaders of these organizations can batten down the hatches or step on the gas pedal (excuse the mixed metaphor). Consumer expectations are rising, and meeting those expectations will take investment. Now is the time to develop an actionable plan for digital transformation—not just to digitize some of the more cumbersome steps in their banking and lending processes but to connect them into a harmonized ecosystem.

- **Change is coming from many directions:** It will be in the form of shifting economic conditions and monetary policy or consumer expectations and market competition.
- **Now is the time for investment:** The current economic cycle may present FIs with opportunities.
- **Focus first on high ROI efforts:** The returns may be financial or in improved customer experience, resulting in higher customer satisfaction or net promoter score (NPS).

INTRODUCTION

The economy is entering a new state of uncertainty caused by geopolitical unrest, unforeseen economic reversals, perplexed equity markets, volatile energy prices, shrinking consumer sentiment, and fluid economic policies in the run-up to the election. Is this today's environment, or have most of these issues been true at any point over the past 60 years? This is not a new state of the economy; it is a constant:

- FIs are facing several challenges.
- Organizations can view the challenges as individual hurdles or as a part of a long continuum of change that should also be a constant.

An Agile technology development approach can help keep things in perspective. Think in terms of "initiatives, epics, and stories," all contained within a backlog. Catalog everything up front, no matter how long it may take to complete, and periodically assess and assign a value to each in terms of positive customer impact.

This white paper, commissioned by Hyland but independently authored by Aite-Novarica Group, looks at eight trends that should be in every FI's backlog. The views and recommendations put forth here are intended to spur on thoughts and actions that senior FI executives may have already been considering but not yet taken the first step.

METHODOLOGY

This white paper draws from desk research and the author's banking career experience and recent interactions within the fintech startup world. These views have been augmented with Aite-Novarica Group's subject matter experts and past syndicated research.

THE EIGHT KEY TRENDS

The following sections address the eight key trends prominent in today's retail banking industry: changes in consumer expectations, fintech business partnerships, becoming a trusted financial advisor, regulatory compliance, modernizing technology, making use of transition time, consumer delinquency, and shifting consumer demographics.

CHANGES IN CONSUMER EXPECTATIONS

How many of us have been amazed in the past three months by something Amazon has done? E.g., delivering a package of AA batteries three hours from when it was ordered. This is great for consumers but exceedingly difficult for the next merchant that needs to deliver a package to them.

Many big tech firms are singularly focused on customers (as all firms should be) and have been delivering extraordinary levels of service to consumers through this focus. There are a few firms making money while doing it, but many are not. These conditions make for a very tough business-to-consumer (B2C) environment in which to operate. As a result, customers' expectations are shifting.

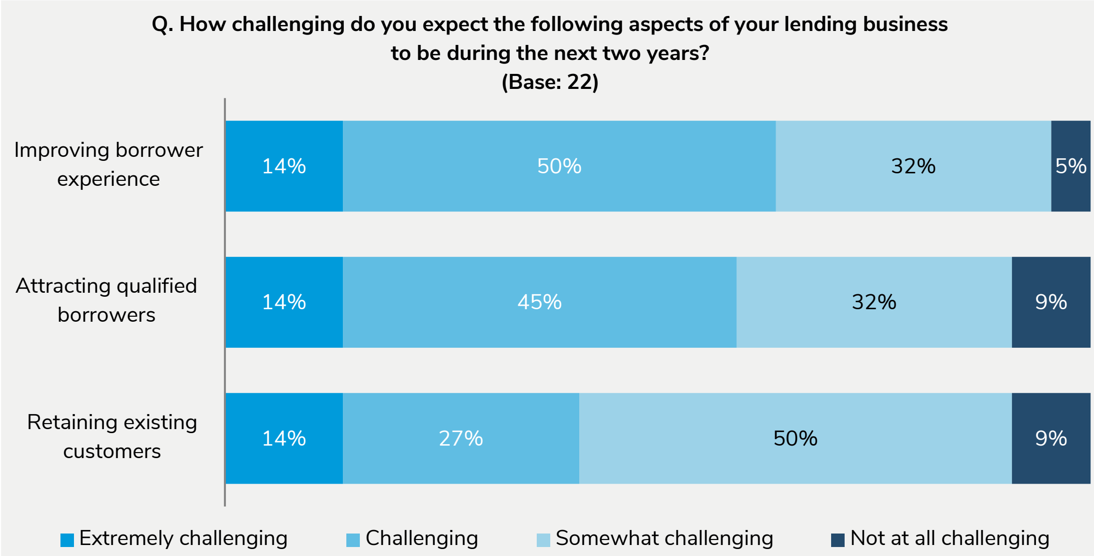
Seventy-four percent of consumers are likely to make their next purchase decision based on their experience alone, and 77% consider their experience more important than the service/product quality. Amazon gets this attitude and delivers on it. Also, among Aite-Novarica Group's learnings about Amazon, it is increasingly less about price. Eighty-six percent of buyers are willing to pay more for an excellent customer experience.[1]

A Google search of "percentage of buyers willing to pay more for great customer experience" results in pages and pages of articles conveying this truism, going all the way back to 2005. There is nothing new to see here.

In an Aite-Novarica Group survey of retail lenders, 64% of respondents said that improving borrower experience was one of their most significant challenges over the next two years (Figure 1).

1 "7 Steps for Creating an Ideal Customer Experience Strategy," Forbes.com, March 10, 2020, accessed August 4, 2022, https://www.forbes.com/sites/insights-treasuredata/2020/03/10/7-steps-for-creating-an-ideal-customer-experience-strategy/?sh=2f7bb8811b62.

FIGURE 1: CHALLENGES FACED BY LENDERS



Source: Aite Group North American consumer lender survey, Q4 2020 and Q1 2021

The benefits of incorporating the infrastructure that will deliver a quality customer experience will pay many different types of dividends. Identify the most critical dividends (e.g., high customer satisfaction score, increased throughput, reduced error rates, lower expenses, mitigated regulatory risk), then select the tools and partners that will deliver that dividend.

PARTNERSHIPS ON THE PATH TO DIGITAL MATURITY

Identifying partnerships that allow or accelerate a retail bank's progress toward a goal should be first and foremost on the collective mind of the organization. This means more than line of business executives coming back from a conference with a handful of business cards.

It isn't easy to become an organization that can identify a need, select a partner that will bring a best-in-class solution to the table, onboard that partner, and integrate it within a reasonable amount of time. Doing so takes the entire organization's cooperation and focus. A purposeful and functioning enterprise third-party management capability is a precursor to a digitally mature organization. The basic tenors of the transformation must support dynamic integrations, REST APIs, web APIs, etc., to build an open platform. The ability to adapt and integrate the technologies of third parties is the most direct route to becoming a flexible, efficient, and customer-focused organization. Ideally, this should be a sprint, not a marathon.

Start at the beginning of the customer experience. Look for partners that can assist in driving digital optimization through the account opening process and provide a 360-degree view of data/documents with the customer at the center. This usually begins with effective data and document capture within account opening processes, leveraging AI to provide a personalized experience. This is also the data upon which the organization can make informed and insightful decisions throughout the customer life cycle.

A conversation about technology partnerships would not be complete without dropping the dreaded business "F" word (fintech) at least once. Determining whether fintech firms are friends or foes is not an effective use of time. Identifying organizational needs such as automated underwriting and finding long-term partners that are laser-focused on that need is another precursor to digital maturity.

The actual threat raised by fintech firms is not that one of them will rise to actual competitor status and win. The genuine danger is that an existing competitor will partner with third parties to fill its gaps and then, in turn, win. This danger applies to existing legacy technology and service providers, not just the new ones.

ACHIEVING TFA STATUS

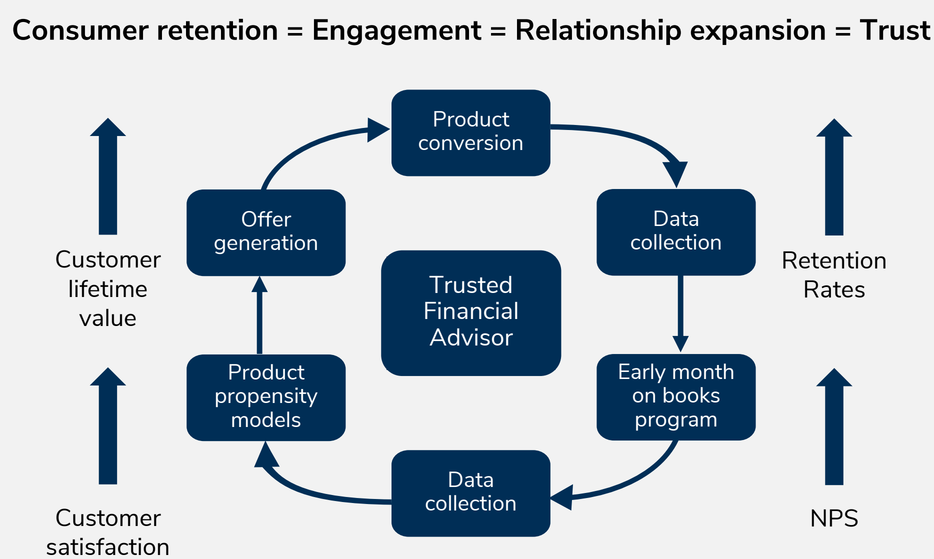
Achieving the status of trusted financial advisor (TFA) with customers is challenging for any FI. It takes a significant investment and coordinated effort across the organization (Figure 2). If it leads to increased retention rates, higher cross-sell, and growing products per household, the investment can represent one of the higher return on investment (ROI) plays for FIs.

The key to increasing cross-sell and products per household is not boosting incentive compensation and selling the same product repeatedly, as one San Francisco Bay area top-three bank learned during the middle of the last decade[2]. It comes from becoming consumers' first thought when considering their next banking product or, better yet,

[2] "Wells Fargo dumps toxic 'cross-selling' metric" money.cnn.com, January 12, 2017, accessed on August 15, 2022, https://money.cnn.com/2017/01/13/investing/wells-fargo-cross-selling-fake-accounts/index.html

introducing consumers to their first thought about their next banking product—determining their needs before they do.

FIGURE 2: PATH TO TRUSTED FINANCIAL ADVISOR



Source: Aite-Novarica Group

Predicting the propensity for a product can happen when the FI achieves TFA status in the consumer's mind (know me, provide me with added value, and take care of me). Doing so is not easy. It means that an FI has achieved the following:

- Done a lot of things right and, in doing so, has met the consumer's expectations
- Captured data that spins off the FI/consumer relationship activity
- Combined the internal data with acquired external data
- Developed the infrastructure and models to house and consume the data
- Created pertinent, timely, and desirable offers
- Provided advice and recommendations based on the consumer's recent activity
- Presented the offer to the consumer where they are (e.g., mobile, online, mail)
- Allowed the consumer to take the offer with a minimum of effort

- Provided the ability to save and resume the process in any channel they choose

Achieving these objectives would require a complex work effort involving skills and capabilities not generally found within an FI below a certain size. Aite-Novarica Group suggests re-reading the section on partnerships.

REGULATORY COMPLIANCE

"I love where we are with our regulatory compliance," said no one ever.

The best regtech definition Aite-Novarica Group has found is: "New technology that may facilitate the delivery of regulatory requirements more efficiently and effectively than existing capabilities." To improve over "existing capabilities," regtech has a low bar to beat.

Regulatory compliance may be the area of FIs in which the least amount of modern technology has been applied, yet it's the area that would benefit the most. There are many reasons why it would benefit: not a revenue center, no immediate impact for failure (unlike fraud), many prerequisite steps, and it is not a shiny object. Since the enactment of The Dodd-Frank Act in 2010, most retail banks have been playing catch-up and not quite achieving a state of cost-efficient and effective compliance. The key to achieving it is relatively simple in concept: Create and consistently track specific documents. It isn't easy to do it piecemeal, applying the solution to various parts of the process. It generally makes more sense to create a genuine end-to-end process all at once, which is difficult.

Although hard to fully capture, an ROI of 600% is possible with a three-year payback associated with regtech investments.[3] Much of the value created by regtech solutions results from the knock-on effects of a modern content management ecosystem: reduced error rates, reporting, pipeline management, increased speed, an elevated customer experience, etc. Content management systems can proactively notify bankers of required or missing documents. Document tracking solutions can help ensure compliance throughout the loan's life cycle by identifying expiring documents and providing support through the loan payoff/lien release process.

[3] Marco Antonio Cavallo, "How RegTech Closes the Gap Between Technology and Financial Services," Bloomberg.com, April 26, 2017, accessed August 4, 2022, https://www.bloomberg.com/professional/blog/regtech-closes-gap-technology-financial-services/.

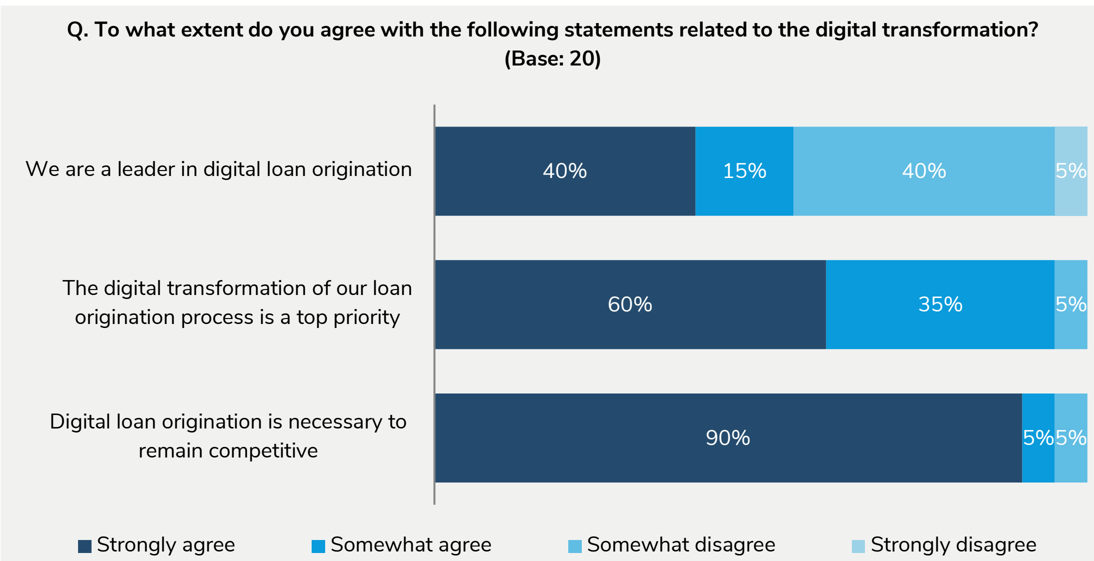
When retail lending leaders were asked, "what will be challenging for your business over the next two years," 60% responded that compliance would be either challenging or extremely challenging[4].

Regtech would be one more area where a partnership would make sense for most FIs. Regulation is a growing, moving target; like most government endeavors, it will not be shrinking any time soon. Non-compliance can result in fines, audits, damaged reputation, and impact the bottom line.

MODERN TECHNOLOGY: THE BEST TECH STACK WINS

Ninety percent of retail lending executives strongly agreed when asked if digital loan origination is necessary to remain competitive (Figure 3).

FIGURE 3: LENDER'S VIEW OF THE IMPORTANCE OF DIGITAL LOAN ORIGINATION



Source: Aite Group North American consumer lender survey, Q4 2020 and Q1 2021

Assume that practically all retail FIs have at least begun their "digital lending transformation journeys." These journeys should be seen more as cycles—journeys lead to an end, but cycles do not. Retail lenders must replace paper and analog processes

[4] Source: Aite Group Q4 2020 and Q1 2021 North American Consumer Lender Survey

with new capabilities that can be upgraded, scaled, and future-proofed. This approach will eventually lead to the build vs. buy/rent decision.

If the goal is to employ a modern technology stack, leading-edge data science, and scalable technical architecture, most FIs will not be able to look inward to build these. One top-three U.S. bank hired (not acquired) a five-year-old fintech company to help rebuild an aged banking core in the cloud.[5] If the biggest banks are unable to do it alone, who can?

Nothing should be off-limits. Loan origination and account management systems are being spun up in the cloud without the cost or hindrance of legacy infrastructure, along with many additional benefits. FIs are increasingly looking at their batch files and seeing better ways to operate.

The new boardroom game is "(_______)-as-a-Service," just fill in the blank. All components of the consumer banking process are being offered as a service. Consider this for these challenging and evolving components: authentication, fraud, document management, regtech, and data management. Two of the newest "-as-a-Service" terms that Aite-Novarica Group has heard are Dispute-Management-as-a-Service (DMaaS)[6] and Fair-Lending-as-a-Service (FLaaS).[7] What will they think of next?

LENDING THROUGH THE CYCLE: MAKING THE MOST OF MARKETS IN TRANSITION

There are no crystal balls, or at least no good ones. In the current evolving rate environment, one should expect mortgage refinances to trail off and home equity lines of credit (HELOCs) and personal loans to pick up. If the downturn is severe enough, auto lending will slow as well. During this transitional period, FIs should take the opportunity to retool for what is coming next.

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5 Karl Flinders, "JP Morgan Chase to Replace Core Banking System With Google-Inspired Cloud Platform" ComputerWeekly.com, September 22, 2021, accessed August 4, 2022, https://www.computerweekly.com/news/252507033/JP-Morgan-Chase-to-replace-core-banking-system-with-Google-inspired-replacement.

6 Omar Faridi, "Quavo Teams up With Qolo to Lower Dispute Processing Costs Using Automation," Crowdfundinsider.com, June 20, 2022, accessed August 4, 2022, https://www.crowdfundinsider.com/2022/06/192500-quavo-teams-up-with-qolo-to-lower-dispute-processing-costs-using-automation/.

7 Penny Crosman, "Fintechs in the Crosshairs: Lenders Deploy Fairness Testing Software," Americanbanker.com, July 18, 2022, accessed August 4, 2022, https://www.americanbanker.com/news/fintechs-in-the-crosshairs-lenders-deploy-fairness-testing-software.

Using enterprise content management (ECM) and the business intelligence built on it could provide invaluable insights as FIs tread into murky waters. There are secondary cost savings to be reaped as well. A few years ago, a large Tier-2 FI embarked on an ECM journey. To help kick things off, it equipped a newly restacked and remodeled 35-story office tower with two printers for the over 2,000 employees who worked there. It's a little draconian, but it did eliminate the paper, saving trees and money.

Another use of the transition time would be to rethink the existing workflows while starting from a clean whiteboard. Digital straight-through processing is no longer just aspirational. Lenders have an opportunity to embark on this transformation journey but will need to divest themselves of the patchwork of paper, batch files, and legacy technologies that have been strung together over time. Making the capital investment in true digital end-to-end solutions sitting on a modern tech stack will boost efficiency ratios through reduced full-time-equivalent employees and cost of error expenses alone.

A newer entrant into the core banking arena has built a very lean, simple workflow model. Although not experienced firsthand, it touts HELOCs that close in five days from application, including recission. There is no substitute for speed.

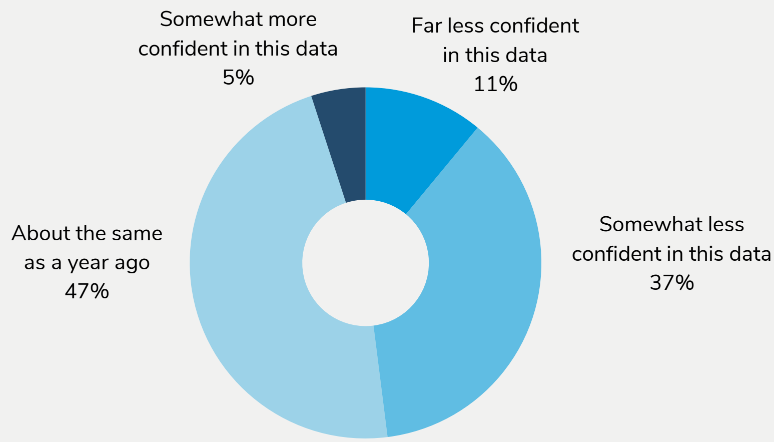
DELINQUENCY AT HISTORICAL LOWS

There is only one way to go from here. In its Q2 2022 earnings call, Chase reported slight declines in consumer delinquency, and nonperforming assets were down slightly from the prior quarter. It sounds positive, right? Actions speak louder than words. In response to the "macroeconomic condition," Chase announced a pause in its share buyback activity to build capital and provide "maximum flexibility" to the firm. This represents JPMorgan Chase's bearish outlook.

Nearly half (48%) of respondents in a recent Aite-Novarica Group survey noted they are less confident in using traditional credit scores to make lending decisions now than a year ago (Figure 4).

FIGURE 4: LENDER CONFIDENCE IN TRADITIONAL CREDIT DATA

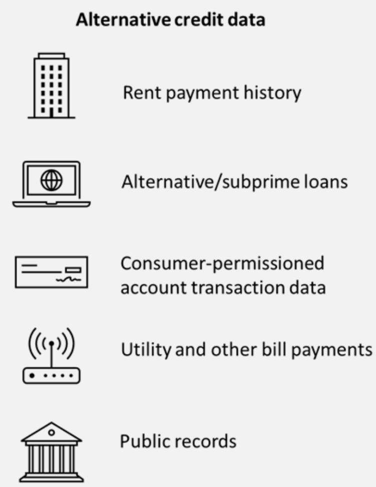
Q. Compared to one year ago, how confident are you in making consumer lending decisions based on traditional credit files and traditional credit scores?
(Base: 19)



Source: Aite Group North American consumer lender survey, Q4 2020 and Q1 2021

So much of what FIs do in consumer credit is based on history repeating itself. This hypothesis is proving inadequate. Combine this with every new economic cycle representing a “first” or something that was not thought possible until it happened. Traditional decisioning data may be losing its effectiveness. This is where alternative data (alt data) comes in (Figure 5).

FIGURE 5: FORMS OF ALTERNATIVE DATA



Source: Aite-Novarica Group

Alt data is usually credit data that was not previously reported and noncredit-related financial data (signals) such as rent payments and utility bills. This data is typically recurring and, like traditional credit, provides its value by tracking trends and looking for anomalies that may indicate something bad has happened.

As alt data evolves, more nonfinancial data is used, primarily nonrecurring data relating to something that the consumer is doing (stopped getting the weekly US$30 car wash) or who the consumer is (never lets the phone battery drain below 60%). These are signals.

Aite-Novarica Group first saw this in Hong Kong in the middle of the last decade; sidewalk "lenders" will loan money after scanning the contents of an applicant's phone.[8] Who an applicant is connected to, what this person follows on social media, and how this person charges the phone battery have all been found to be very predictive. Advanced AI firms are collecting signals of all types and identifying patterns that offer a picture of pre-fraud and pre-delinquency activity based on this more extensive set of signals and more real-time input. This data can go a long way to bolster collections and risk management capabilities.

8 Li Yuan, "Want a Loan in China? Keep Your Phone Charged," The Wall Street Journal, April 6, 2017, accessed August 4, 2022, https://www.wsj.com/articles/want-a-loan-in-china-keep-your-phone-charged-1491474250.

SHIFTING CONSUMER DEMOGRAPHICS

"The times they are a-changin'." The baby boomers are riding off into the sunset, and Gen X is not far behind them. Now what?

FIs need strategies to adjust their institution's approach to attracting and engaging consumers. It may not be necessary to meet the millennials where they are (e.g., mobile, online, mail), but it is time to shift some current methods within legacy banking.

Several large legacy banks have tried to spin off new brands and platforms to engage younger consumers. These have met varying degrees of success. For example, Goldman Sach's Marcus and BBVA's Simple open banking platform have had some success.[9] On the other hand, after significant investments, Chase Bank's Finn and Citi's Plex barely saw the light of day. A new brand and platform narrowly focused on these cohorts may not be the answer.

Neobanks are working to engage younger cohorts, hoping these burgeoning consumers stick with their quirky, oddly named "almost a bank." Betting on long-standing customer loyalty is a long shot at best and even more challenging to make money while doing it. These younger demographic groups have not all reached their adult earning/spending stage of life. They simply do not yet need a lot more than a debit card.

As Gen Z and younger millennials start to move toward their peak spending and borrowing years, will Chime and Varo be able to meet all their needs? Aite-Novarica Group thinks this is an opportunity for the traditional FIs to step up, but they will need to adjust to make it work. These younger consumers have become accustomed to a more satisfying banking experience that is fast and frictionless without punitive fees. They have also grown up with access to superior planning, investing, crypto, budgeting, and spend control/management tools—all of this being delivered to them digitally, having never set foot in a branch.

The good news is that these cohorts are more comfortable conducting all their banking services with one institution than their forefathers, who purposely spread their assets and liabilities across several banks. The bottom line is that digital banking capabilities will significantly influence consumers' willingness to do business with an FI, driving customers to modern full-service digital banks.

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9 Simple was a viable challenger bank until it was shuttered following PNC's acquisition of BBVA.

CONCLUSION

This white paper on what retail banks are facing and what they should do about it is extremely liberal with its suggestions regarding time, space, and funding. To succeed, FIs must stay focused on doing what's possible regarding the eight key trends and not get dragged down into the quagmire of the day's challenges. FIs should acknowledge and do the following:

- Most bank consumers receive excellent service from a merchant or service provider they deal with regularly. This is the bar by which they judge their FIs.
- Break down and componentize the primary workflows within the organization and work toward a platform that can support best-in-class solutions for each function.
- Develop a clear vision of the ideal relationship consumers value most and build backward from there, customer experience first, vis-a-vis design thinking.
- Deploying a platform (e.g., workflow, ECM) that supports the organization's regtech requirements is not an end unto itself, as the secondary benefits are excellent and plentiful.
- The best tech stack wins: digital, straight-through processing, real time, and cloud-native.
- Digital transformation means a lot of different things, but simply put, use the time between the macrocycles to retool, and think about using enterprise solutions (e.g., ECM, business intelligence, workflows).
- Reduce servicing, delinquency, and fraud expenses by adopting AI utilizing alt data to improve efficiencies dramatically.
- What is working today (current products with current service delivery) will NOT work tomorrow; the change in consumer preferences (via demographic shifts) is accelerating.

ABOUT HYLAND

Hyland accelerates the digital strategy for financial institutions by unlocking the value of content — inside and outside of core systems. Secure, cloud-based content and digital process automation solutions from Hyland enables greater collaboration and more efficient operations. More than 3,500 financial institutions leverage Hyland solutions to drive digital transformation, support regulatory compliance and improve omni-channel customer experience. Learn more at Hyland.com/FinancialServices.

ABOUT AITE-NOVARICA GROUP

Aite-Novarica Group is an advisory firm providing mission-critical insights on technology, regulations, strategy, and operations to hundreds of banks, insurers, payments providers, and investment firms—as well as the technology and service providers that support them. Comprising former senior technology, strategy, and operations executives as well as experienced researchers and consultants, our experts provide actionable advice to our client base, leveraging deep insights developed via our extensive network of clients and other industry contacts.

CONTACT

Research and consulting services:
Aite-Novarica Group Sales
+1.617.338.6050
sales@aite-novarica.com

Press and conference inquiries:
Aite-Novarica Group PR
+1.617.398.5048
pr@aite-novarica.com

For all other inquiries, contact:
info@aite-novarica.com

Global headquarters:
280 Summer Street, 6th Floor
Boston, MA 02210
www.aite-novarica.com

AUTHOR INFORMATION

Stewart Watterson
+1.216.978.4460
swatterson@aite-novarica.com