7 Big Changes Ahead for Banks to Prepare for

Big changes are ahead for banking organizations of all types and sizes. Here's what banks need to keep in mind to succeed in the next era of banking.

In the first half of 2023, business-as-usual took a back seat in banking—way back.

Now, many banks are taking steps to move beyond the financial crisis and resume normal operations. But even as the industry was preoccupied with bank failures, regulatory and technology advances continued to march forward—sometimes in dramatic ways.

As banks consider their next steps for modernizing operations, here are seven areas we predict will bring about the biggest change:

1. Embedded banking

Competition for banking customers is tough, and the stakes grew higher in April, when Apple entered the buy-now-pay-later market. Apple's competitive foray was followed two weeks later by the company's rollout of high-yield savings accounts for Apple Card users.

The next move belongs to incumbent banks: As fintechs multiply and customers become more comfortable using mobile phones' tap-and-swipe convenience to manage their finances, it's up to traditional banks to adapt to customer expectations by implementing secure, user-friendly digital platforms.

Using data-driven customer analytics, these platforms enable banks to embrace hyperpersonalized offers and lifestyle banking, including pre-approved loans, customized product or service recommendations, and targeted promotions.

For example, when our team partnered with a West Coast commercial bank to ideate and develop a mobile-first platform, the new omnichannel customer experience paid off with big dividends for the bank. Market share rose 30%, and operational efficiency increased 23%. An accelerated two-month timeline for the minimum viable product (MVP) release enabled the bank to get to market quickly.

There's plenty of efficiency occurring in back-end operations, too: We leveraged AI to help a global financial tech company automate its merchant check processing capability and reduce effort by 65%.

2. Open banking

When it comes to their financial data, customers crave choice, convenience and control. Open banking provides it. It serves as the engine for embedded banking, and enables hyperpersonalization and lifestyle banking, as well.

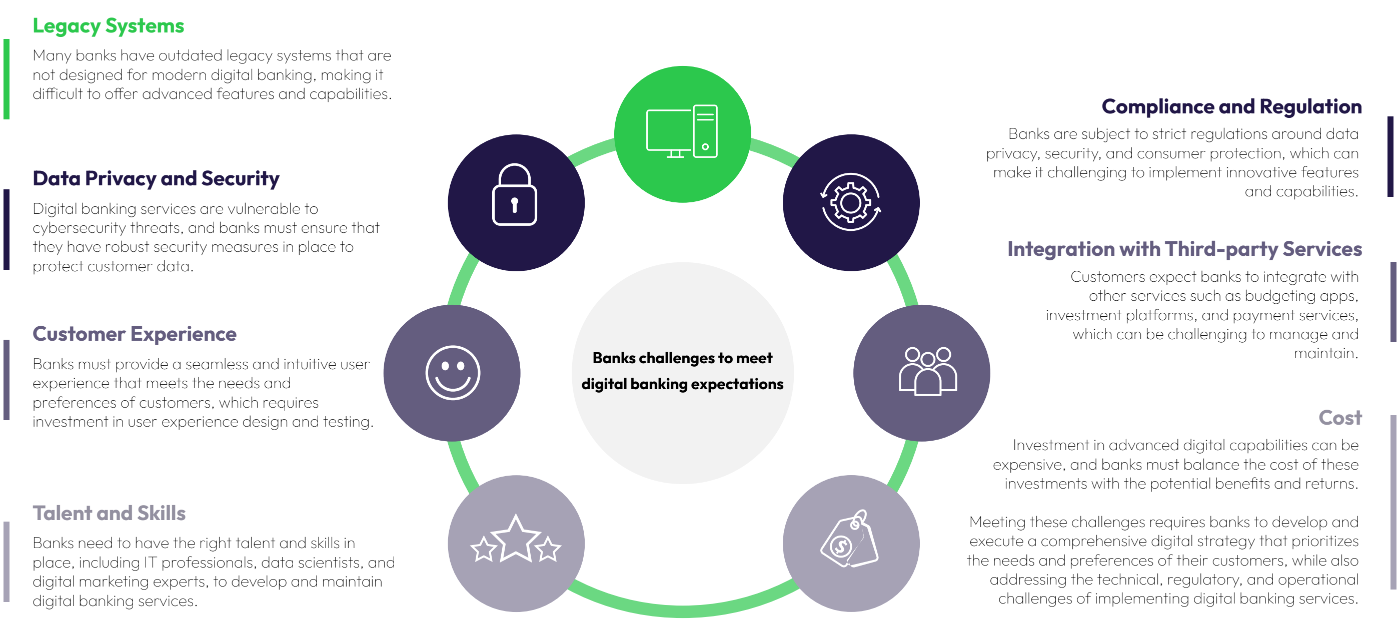
Spurred by the Consumer Financial Protection Bureau's 2022 announcement of a new regulatory framework, open banking is expected to gain traction in the US later this year when the CFPB proposes its long-awaited rule on secure data sharing. Already, the agency is facing pressure to expand coverage of the rule to include mortgages, student and auto loans, and other credit accounts.

Advocates hope the new regulations will propel open banking in the US to the same heights it has achieved in countries such as Brazil, India and the UK. In the UK, open banking's seven million active users account for 71% of small and medium enterprises in the country, and 64% of adults.

Yet the integration that open banking requires remains a challenge for banks, especially as they collaborate with fintechs. Incumbent banks report that integration with core and ancillary systems are the top two hurdles when partnering with fintechs, followed closely by integration with digital banking platforms and lack of API experience.

API security, too, is attracting attention. The Federal Reserve's SR21-14 guidelines seek to reduce risks related to authentication and access, and a 2022 report found that nearly one-third of malicious requests target "shadow APIs," or unknown, unmanaged or unprotected APIs.

Uncertainty aside, open banking is a sure path to success in the fast-evolving financial landscape. We see strategic roles for banks, both as back-end service providers, emphasizing standards and compliance, and as owners of the customer relationship through superior digital banking experiences, offering tailored financial products and services.



Meeting the high expectations of customers for digital banking services can be a challenging task for banks. Here are some of the main challenges they face.

Figure 1

3. Green banking

Banks view sustainability through two lenses: one that looks inward at internal operations, and another that looks outward at external business opportunities in lending and investment.

Increasingly, the inward view of climate-related financial risks is under scrutiny. A pilot climate scenario analysis launched by the Federal Reserve requires six of the largest US banks to determine their capacity to identify, measure and monitor hazards due to global warming and weather events. Announced in September 2022, the pilot asks the top banks—Bank of America, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley and Wells Fargo—to forecast the impact of severe weather on their residential and commercial real estate lending portfolios over a one-year timeline.

Banking, however, isn't the only industry facing scrutiny. Federal agencies are taking note of climate preparedness across all sectors. The Securities and Exchange Commission's forthcoming climate disclosure rule will require public companies to report climate-related risks and emissions data. About 70% of companies intend to comply with the rule regardless of when it becomes final, according to a survey released in March 2023.

That's good news for banks looking to promote environmental sustainability as a competitive differentiator. Potential use cases for green banking cross the B2C and B2B sectors. They range from loans and mortgages that incentivize customers to invest in energy-efficient homes and sustainable energy systems, to infrastructure projects that include renewable energy plants and support for the transition to a low-carbon economy.

4. Core transformation

Traditional large banks face a critical buy-or-build decision as they position themselves to compete with neobanks: Do they implement a new digital banking platform from the ground up, or modernize their existing core systems? The answer holds great significance as banks determine the best path to adapting to dynamic market demands and succeeding in the neobanking era.

With no legacy architecture and no technical debt, neobanks' cloud-based platforms give them a huge advantage over incumbent banks. Yet large incumbents' deep pockets are funding a push into online banking by the likes of JPMorgan Chase. The company's UK digital retail bank, Chase, signed up one million customers and $10 billion in deposits in its first year of operation and is now set to expand into Germany.

At the same time, digital challenger banks are consolidating, with only 5% of the 500 or so neobanks profitable.

We see a clear opportunity for established banks to determine the best path into neobanking. Core banking solution providers are responding to the demand for agility and innovation by releasing cloud-native versions of their systems.

5. Payment standardization

The new ISO 20022 standard is on. The global standard for payment protocols is set to become the much-needed common platform for faster, more accurate transactions, especially in cross-border payments.

The pace of ISO 20022 implementation varies around the globe. The Asia-Pacific region leads adoption, with China, Japan and India already live. SWIFT, the global interbank messaging system, went live with ISO 20022 in March 2023.

The US rollout is slower but still moving ahead. The Clearing House (TCH) rescheduled to April 2024 the planned ISO 20022 migration for its CHIPS system, which settles the majority of high-value USD banking transactions. The Federal Reserve plans to adopt the standard for its Fedwire Funds service in March 2025.

For financial institutions, the migration of payment message formats to ISO 20022 introduces a host of benefits, from better interoperability to more reliable documentation and greater protection for anti-money laundering and combating the financing of terrorism (AML/CFT).

A leading financial services provider increased time to market by 32% due to the platform integration module our team designed and built for processing ISO 20022 transaction and clearing messages. Not only can the company connect its product with multiple banks without delay, but it also gained an easily scalable architecture aligned to a tech refresh roadmap.

6. Real-time payments

While card-based transactions remain hugely profitable for banks, instant payments loom as both a game changer and a disruptive force. The Federal Reserve's instant payment service, FedNow, is expected to jumpstart use of non-card-based transactions. So far, 35 banks have signed up as early adopters of the service, which went live in July.

Yet real-time payments will require major shifts for banks and financial institutions. For one thing, many struggle with monetizing the no-fee/low-fee model of non-card-based payments. For another, banks that are slow to modernize their IT environments will be unequipped for the cloud-based infrastructure and interoperability that instant payments require.

Integration will be key, especially for the migration to FedNow. We're now working with partners, including B2B solution provider Payment Components, to help customers integrate existing systems with FedNow and scope out the complexity of the migration and middleware integration.

7. AI-driven chatbot solutions

Generative AI needs no introduction. There's good reason the technology has captured financial headlines since its release in late 2022: Its ability to create new outputs makes it a jack-of-all trades in banking, ready to tackle tasks that range from interpreting loan applications to creating synthetic data that trains the machine learning algorithms used in KYC.

In our work with wealth management firms, we're exploring generative AI-powered chatbots and finding it to be an area of huge potential. As finance customers continue the shift to digital channels, chatbot agents are set to go beyond basic interactions like balance inquiries and recent deposits. They're positioned to answer nuanced questions in real time about financial performance in complex scenarios, as well as create call summaries, which reduces overall support costs.

Chatbots have already made waves in banking, with 37% of the US population engaging with a bank chatbot in 2022, according to a report released in June from the CFPB. The report also points out that with chatbots' potential comes responsibility. It served notice to the banking and finance industry that deploying chatbot technology requires responsible implementation, which means not only providing quality service but also remaining fully compliant with regulations and the ability to safeguard consumers' data.

About the Author

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Ashraf is a seasoned technology executive with over 23 years of experience in the information technology and service industry. He currently serves as the Chief Technology Officer of Banking, Financial Services, and Insurance at Brillio, where he leads the company's BFSI vertical growth by building domain solutions.

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