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TOMORROW'S BANKING

The Digital Transformation of Financial Institutions

2022

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FACING THE DIGITAL ERA OF FINANCIAL SERVICES

The wake of the pandemic brought about many challenges, like a rapidly increased reliance on digital solutions in the front, and closed branches, unprepared call centers, and overwhelmed lenders dealing with PPP loans in the back. More importantly, it presented financial institutions with a timely opportunity: a call for innovation.

According to a late 2020 IDC survey, only 20% of financial systems worldwide said they'd "recovered to a new normal" from the effects of COVID-19 on their internal systems. Yet the shift is here to stay.

In Plaid's 2021 survey on fintech use, 88% of U.S. respondents said they use technology to manage their finances. This jumped from over half (58%) of respondents in 2020.

This new digital era is an opportunity for financial institutions to remain agile in the face of constant change. Fintechs, companies applying modern technology and user experiences to financial services, are filling gaps traditionally overlooked by financial institutions.

88% **of Americans manage their finances digitally**

Proven digital transformation strategies include improving the onboarding flow, automating the processes of depositing and borrowing funds, reimagining overdraft protection and early access to paychecks, and eliminating data silos.

In this whitepaper, we explore the opportunity presented by digital transformation, key challenges financial institutions face, a step-by-step strategy to tackle those issues, and the technologies driving digital transformation into tomorrow.

> "We're not going back to the old days -- we still see millions of customers who use our branches, but they're using our branches differently. And so they're coming for advice. They're coming for complicated financial plans. It's a different experience, and customers are shifting more and more of their transactions to our digital channels."
>
> **Allison Beer, CPO & Head of Digital, Chase**

Digital transformation means prioritizing the customer experience

From account opening to card issuance to lending, each customer journey includes multiple touchpoints via online, mobile, in-branch, and over the phone -- where banks can leverage new technologies and data to create better, more personalized experiences.

Digital transformation is not merely the act of creating new digital products and services; it also means revamping existing legacy systems by partnering with third-party applications to layer in new services. For example, online lending marketplace LendingTree partnered with Plaid to extend into financial services beyond lending. With Plaid, LendingTree was able to link customers' external accounts to get a complete picture of their financial data, which made it possible for them to offer personalized financial services that boosted engagement while giving users a more holistic view of their finances.

> "When you build a business, you begin with the customer -- the north star of the business has to be addressing customer problems... We spoke to more than 10,000 consumers to understand their pain points and how we can address them. We've used data, design, and engineering, along with competencies in risk management, marketing, operations, etc. -- but the real magic is bringing all those capabilities together to make things simple, transparent, and valuable for consumers."
>
> **Harit Talwar, Chairman of Consumer Business at Marcus, Goldman Sachs**

The best customer journeys are built on strong foundations

Financial institutions stand out by creating an omnichannel customer experience, from web and mobile to the call center and branch, where a customer can begin an interaction in one channel and complete it seamlessly in another.

Front-end	Back-end
• Consistent CX across all channels • Personalized financial insights • Seamless mobile and online banking • New solutions that exceed expectations	• Connected data and systems • Automated processes • Cloud-based infrastructure • Artificial intelligence and machine learning

Digital transformation on the back-end means **eliminating data silos** and **automating digital processes**. AI, machine learning, and cloud-based systems can address customer needs while helping the bank streamline operations and reconciliation activities around its offerings. The result is repeatable, optimized processes that benefit the customer and enable the back office to scale.

DIGITAL TRANSFORMATION PITFALLS FOR FINANCIAL INSTITUTIONS TO AVOID

To keep your digital transformation efforts on track, avoid these common pitfalls.

Playing the waiting game. Businesses that 'fix it before it breaks' gain much more from their digital transformation efforts. While it may seem appealing to wait and see if there is truly a problem to fix before taking action, companies that start earlier can generate significantly more value over a three-year period.

Failing slowly. With today's cloud-based technologies, it's faster and easier than ever to launch new products and services. Being more agile and striving to launch sooner gives companies the chance to quickly iterate and improve features, or dismiss offers that seem worthwhile but in effect do not resonate with customers.

Not fixing high-friction processes. Legally mandated procedures like KYC and AML require a strong system in place that can monitor and evaluate new customers. Frequently, customers are asked to embark on secondary customer journeys to manually collect and submit paper forms for their applications. The result is high friction in steps like account opening and loan applications.

Transforming the obsolete. Increasing efficiency and reducing costs are certainly important, but digital transformation is chiefly about creating new offerings and experiences that improve upon existing technologies to maximize efficiency and customer centricity.

Keeping data silos. In the age of Amazon, where customers get personalized products and services, siloed data still needs to be wrangled. And it must, if the provider is competing against online experiences like Netflix recommendations, for example.

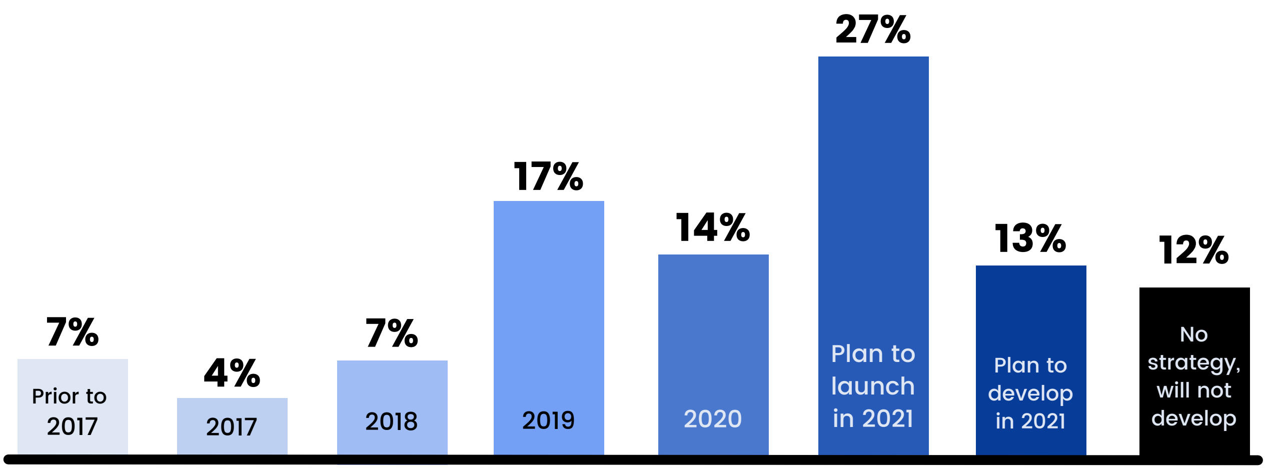
Fintechs and financial institutions must have a clear picture of who their customers are and how they can serve them. It's not just legacy technology that can get in the way of being digital -- it's also legacy thinking.

Only competing with other financial institutions. When evaluating who to benchmark themselves against, banks naturally look at other banks. Customers, on the other hand, do not. They're more likely to compare their experience using digital banking platforms to other digital platforms such as Amazon or Google.

Only responding to customers' current needs. Meeting the needs of the existing customer base is vital for retention. At the same time, innovating for the future of banking requires looking outside the customer base as well, and building for what customers may want down the line.

Slowing down. An important factor to keep in mind is that change is constant, meaning digital transformation never ends. When a financial institution starts to slow their efforts is when they're most vulnerable to disruption, no matter how much they've already achieved.

When did your bank launch its digital transformation strategy?

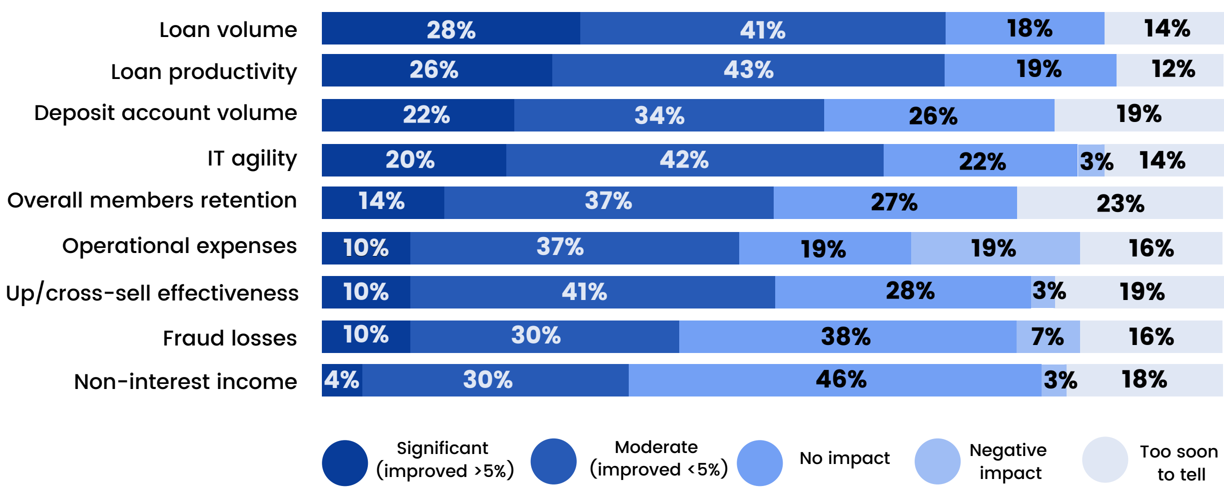


Source: Cornerstone Advisors survey of 260 community-based financial institution executives, 2021

7 STEPS FOR FINANCIAL INSTITUTIONS TO BEGIN OR ACCELERATE DIGITAL TRANSFORMATION

Digital transformation can take many different shapes, and most financial institutions are already digitally transforming in some respect. The following steps will help accelerate these efforts to generate the greatest impact.

What impact has your digital transformation strategy had on the following business metrics?



Source: Cornerstone Advisors survey of 260 community-based financial institution executives, 2021

1. Get leadership buy-in

Digital transformation requires a cultural revamp that leads to new, innovative ways of thinking. To gain buy-in across the business, leadership needs a clear and concise digital transformation strategy with:

1) focus on long-term ROI and the creation of a lasting competitive advantage, and 2) plan to ensure the company can thrive through the transformation.

Wells Fargo's Head of Technology Saul Van Beurden oversees 40,000 tech employees and a $9 billion budget. To set the innovation strategy for the entire enterprise, Saul breaks it down into six items, known as the "6S strategy" -- skills, security, stability, scalability, speed, and satisfaction. By keeping this strategy simple yet effective, Saul makes it easy for employees to get on board and keep digital transformation efforts high priority.

2. Invest in the right data platforms

Having access to real-time, relevant data enables you to create the services, apps, and experiences that keep customers engaged. Older systems that were built without data integration in mind effectively keep data in silos. When relevant data exists in a siloed system -- such as within an application that nobody outside a certain department has access to -- it can't be leveraged to power digital transformation.

To unlock siloed data, financial institutions should invest in centralized "data linking" systems that act as an overlay to connect siloed data. These systems pull data from many disparate sources into a single, unified platform, making it usable for insights and actions. To create data linking systems, financial institutions can either build them internally or work with a vendor like SnowFlake Data Cloud.

3. Forge the right partnerships

Partnering with platforms like Plaid can give financial institutions access to an open ecosystem of financial data, allowing them to build apps and services that deliver the new experiences their customers crave.

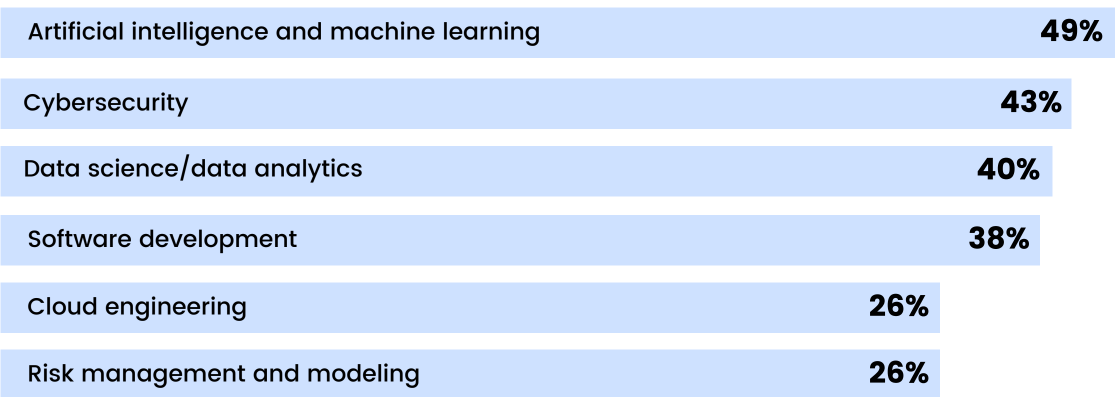
Marketing and co-branded partnerships can also fuel digital transformation. When Goldman Sachs decided to transform into a main street bank, it needed to scale quickly to replace lost revenue. Going directly to customers can only grow so fast, so the company decided to pursue a parallel partnership strategy by powering financial services for popular consumer brands. Powering the Apple Card, for example, gave Marcus the experience of both underwriting via API partners and managing a customer debt portfolio led by the world's strongest tech brand.

4. Recruit the right people

Recruiting the right talent starts with creating the right culture. Companies that succeed in recruiting talent embrace a culture of innovation. Even financial institutions that know they want to hire innovative talent can find it challenging to do so. In fact, 50% of financial institutions say it is either difficult or very difficult to find IT talent, while only 12% say it's easy. To help fill the tech talent gap, financial institutions can create a culture of innovation by making innovation a top priority and promoting it through recruitment, content, and PR efforts.

Special incentives work to recruit tech workers as well. First Republic Bank offers to pay off their employees' student loans, for example. An even simpler solution is to offer a high salary that competes with companies like Google and Amazon.

Most difficult niche technical areas for hiring skilled candidates



Source: The Deloitte Center for Financial Services Global Outlook Survey, 2021

5. Identify and prioritize gaps where digital transformation is needed

Once a financial institution obtains the talent they need, they can identify gaps to fill with digital transformation. In practice, this means analyzing internal data to identify where customers are getting stuck and then researching the market forces and industry disruptors that address these pain points.

Finding and eliminating friction in traditionally sticky areas, such as new account opening and funding, will smooth out the customer journey while accommodating the modern attention span, which is only only eight seconds. For example, Chime, a digital-first bank, decreased the time it takes to open a new account down to 15 minutes, helping grow their customer base to roughly the same size as US Bank in just a few years.

The customer acquisition cost (CAC) for banks averages $925 per new customer. The easier it is to fund new accounts, the more ROI the bank will get on that upfront CAC. For example, microdeposits can take up to five business days, while instant verification via Plaid Link takes as little as seven seconds. Plus, by establishing a connection with the customer's outside financial accounts, banks can do things like confirm the users' identity and verify the balance of their outside accounts, smoothing the CX while decreasing fraud and increasing revenue.

6. Map new solutions according to customer needs

Customer data can be used to recommend things like loan offers, debt consolidation, savings, and investments. It can also be used to create personal financial management tools that give users deeper insights on areas like growing wealth and paying off debt. For example, Bank of America's virtual financial assistant Erica offers personalized insights through the bank's mobile app, and tools that include spending snapshots, viewing balances across all accounts, refund confirmation, recurring charges monitoring, and bill reminders.

A great example of a digital transformation solution comes from RBC. Five years before the pandemic, RBC committed to digital transformation across their entire service catalog. The commitment paid off, particularly when the pandemic forced their customers to rely entirely on digital banking channels. As a result of their digital transformation efforts, RBC created the NOMI online platform, an AI-based assistant that offers insights, budgeting, savings opportunities, and a Q&A chatbot. NOMI has become a valuable tool for customers to better understand their finances, and has led them to spend more time engaging with the bank, especially during the pandemic.

7. Track your success and keep transforming

To know if your new solutions are making an impact, you need to select and track several KPIs. According to Gartner, digital transformation initiatives should track 5-9 KPIs, and they should be kept to simple, impactful metrics that can influence business decision making.

For a new financial solution, KPIs could include user adoption rate, reduced time to fund new accounts, customer experience survey results, and money saved. KPIs will also vary across institutions, with each using their own metrics to measure their own success, and across the stages of integration. For example, for an institution launching a robo-advisor, an initial metric would be user adoption rate, which would later change to retention and time spent on the app.

Digital transformation requires constant assessments of customer needs. This includes implementing interventions for improving response to crises, and measures for improving information systems such as analytics, forecasting, and changing risk models. This helps build more accurate customer personas and improve personalization engines. Financial institutions can commit to an operational model with continual improvement built into the core strategy. Transformation is not a single step but an ongoing process of adjusting and creating services to best suit customers.

To buy, partner, or build?

When going through the steps above, financial institutions will typically end up considering three options:

1. Staff a team to build and maintain a solution internally
2. Hire an implementation partner for the build
3. Partner with a vendor to build it all

The right answer will depend on your resources as well as demands for cost, efficiency, and speed. A large financial institution may have the recruiting power to staff its own technical teams to build and maintain solutions, while a smaller institution may not. For midsize institutions, it could end up being a mix of hiring and partnering to reach the right equilibrium. There are also benefits to hiring a vendor to quickly create a white label solution that meets an immediate need, as opposed to staffing an internal team that can take much longer when starting from scratch.

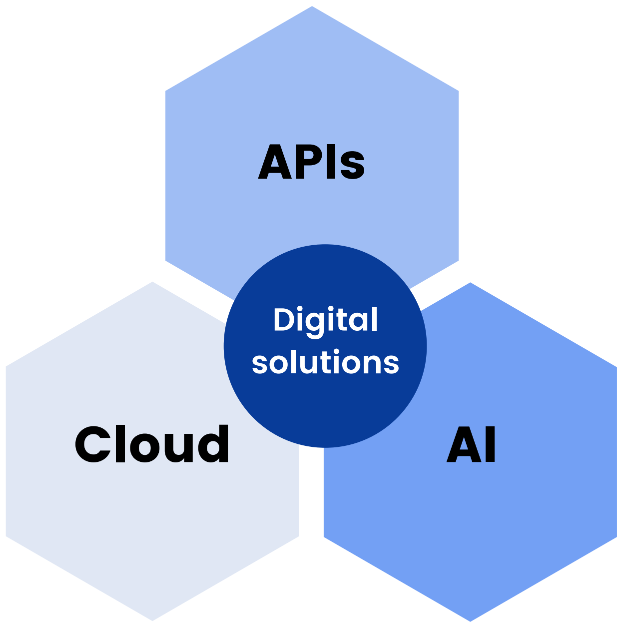
> "It's all about embedding financial solutions at the point in time of need for a customer… Embedding all the other solutions that are necessary, as opposed to just giving them the advice and then letting the customer figure out over time what action to take."
>
> **Eric Sager, COO, Plaid**

TECHNOLOGIES AND THE FUTURE OF FINANCIAL SERVICES: BUILDING DIGITAL EXPERIENCES THAT CUSTOMERS LOVE

New solutions that arise from digital transformation efforts can come from anywhere. And some are making a bigger splash in the financial services industry than others, including APIs, cloud, and AI.

Application Programming Interfaces (APIs)

Today, APIs create a secure way to exchange financial data between financial accounts and both internal and external applications. APIs make it easier to create solutions for multiple use cases, such as new account funding, personal financial management, wealth management, loan verification, and more.



> "Consumers will growingly want to have more visibility and transparency into what information is being shared, and where, and then have the ability to do something easily about that if they don't agree."
>
> **Gareth Gaston, EVP & Chief Digital Officer of Enterprise Platforms & Capabilities, US Bank**

With open APIs, banks create a safer way for customers to utilize their financial data as they see fit -- as well as help banks partner with vendors who can build new apps and services. Plaid Exchange, for example, is an open-API platform that makes it easy for banks to implement safe external APIs while helping their customers do more with their financial data.

Cloud

Access to customer financial data across every part of the customer journey helps to modernize infrastructure and create a consistent omnichannel customer experience. To achieve the flexibility they need for digital transformation, CIOs are increasingly shifting their operations to public and private clouds.

However, 'lift-and-shift' services that simply migrate legacy applications to cloud-based servers are not necessarily the answer.

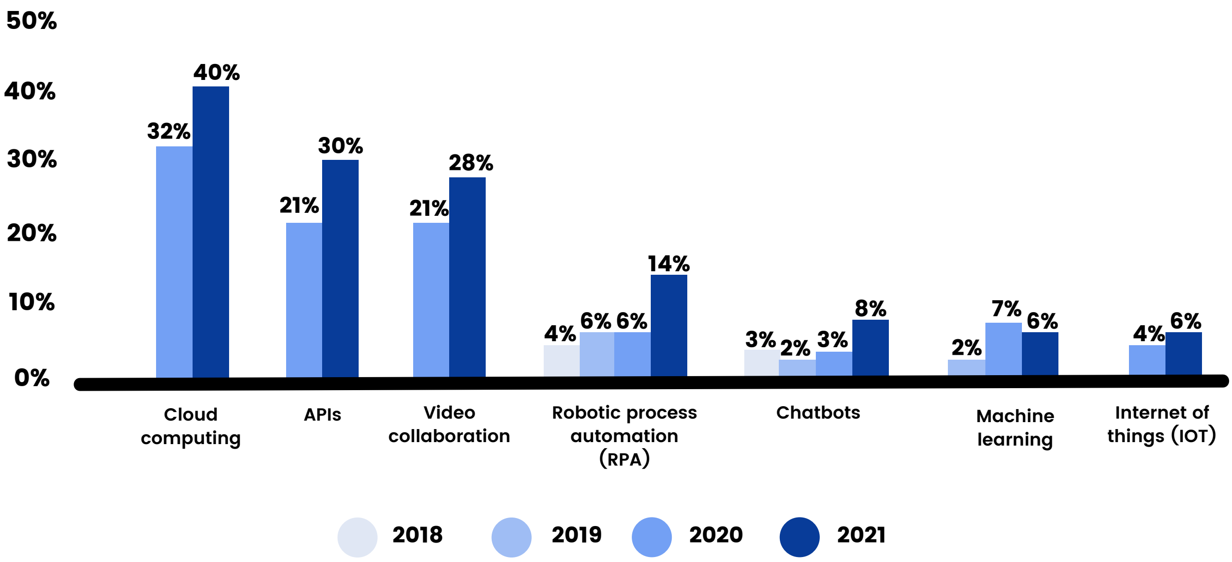
With successful implementations that take advantage of cloud technologies, financial institutions can expect to go to market faster with new digital products and ensure that they are secure, scalable, and fast enough to meet growing demands.

Artificial Intelligence (AI)

AI has numerous applications within the financial services industry, including chatbot assistants, fraudulent activity detectors, and back-end task automators. It's estimated that AI will save the banking industry $447 billion by 2023, with 80% of banks aware of its potential benefits.

AI has the potential to improve customer experiences by offering 24/7 services and streamlining tedious processes. For example, Invesco found that its AI tools help investors to make better investment decisions and makes its distribution professionals more efficient. As banking moves further towards digital and mobile channels, the opportunity grows for AI to make an even bigger impact for fintechs and incumbents.

Banks that had already deployed technology going into 2018-2021



Source: Cornerstone Advisors survey of community-based financial institution executives, 2021

Final thoughts

With an array of powerful technologies, financial institutions have a massive opportunity to build the seamless digital experiences that customers expect. By breaking data silos and emulating customer experiences outside the industry, banking experiences can be as frictionless and personalized as the customer experiences pioneered by Netflix and Amazon.

Likewise, by implementing digital transformation best practices, incumbent financial institutions can stave off challenger banks, fintechs, and big tech companies acquiring their customers, taking market share, and siphoning off their revenue. Financial institutions can create new experiences that customers love. That’s an important path forward to retain existing customers and gain new ones in an industry undergoing constant change.