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WHAT'S GOING ON IN BANKING 2019

Community-Based FIs' Priorities, Fintech Plans and Future-Readiness

IS THE PARTY OVER?

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EXECUTIVE SUMMARY

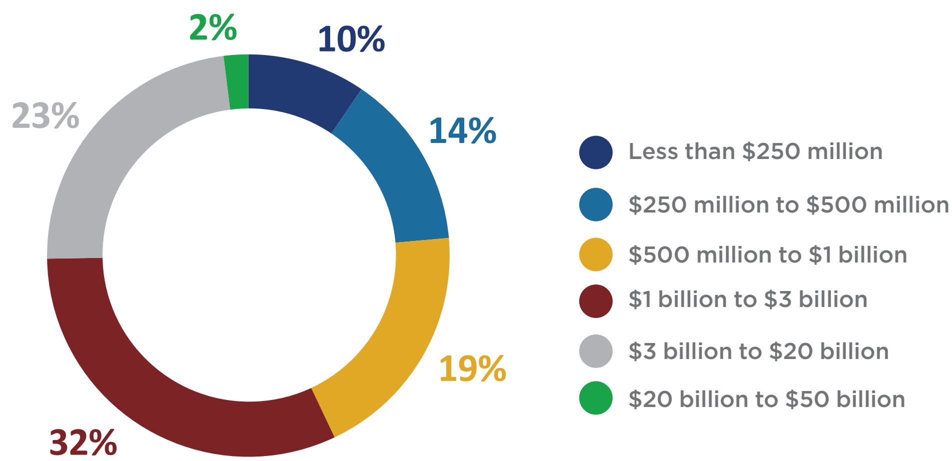
SO WHAT

- **Is the party over?** The Trump bump is turning into the Trump slump. CEO optimism for 2019—which hit a five-year high in 2017 following the election of Donald Trump—slips for the second straight year amid concerns about higher interest rates and challenges in deposit gathering.
- **Deposit displacement is impacting financial institutions.** Growing deposits is at the top of banks' and credit unions' growth priorities for the coming year. The effect of deposit displacement—the diversion of funds from checking to alternative accounts—is making deposit retention difficult.
- **Let's get digital.** Expanding digital presence is a priority for an increasing number of bank and credit union executives—finally. Among bank execs, this seems to come at the expense of improving marketing and sales capabilities. One aspect of this focus on digital that comes shining through is the emphasis on digital account opening, in terms of new investments and fintech partnerships.
- **Future-ready fantasies?** Going into 2017, we chided FI execs for being too optimistic about the future-readiness of their operations. In 2018, we saw a more sobering view, particularly among credit union execs whose future-ready assessments declined in seven of the eight functions we asked about. The past year (2018) must have been a productive one as future-ready ratings from both bank and credit union execs improved in most categories. Considering the slow uptake of emerging technologies, we can't help but think many executives are deceiving themselves.
- **Maybe we should call them coffee-table technologies.** Coffee-table books are there to generate conversation, and it looks like that's mostly what's happening with emerging technologies like artificial intelligence (AI), machine learning and robotics process automation (RPA). Most of the activity here is discussions at the board or executive team level. We suspect that many execs simply don't know what they have, as RPA has been embedded in apps for years.
- **The fintech partnership proliferation.** Half of banks and credit unions say fintech partnerships will be important in 2019. Digital account opening, payments and lending top the list of fintech-related priorities. We wonder where these institutions will get the skills to vet and negotiate with potential partners.

ABOUT THE DATA

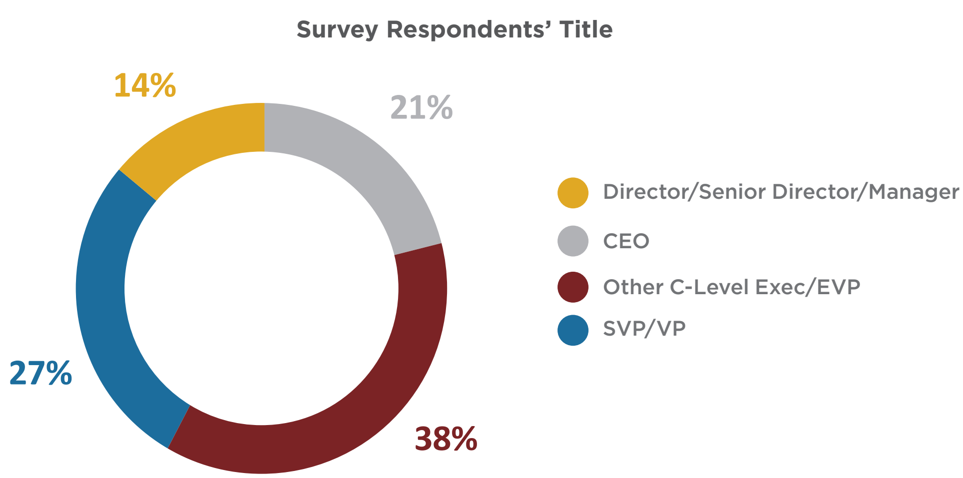
In Q4 2018, Cornerstone Advisors surveyed 305 senior executives at U.S.-based mid-size financial institutions (FIs), 60% from banks and 40% from credit unions. About one in five respondents is with an FI with $500 million to $1 billion in assets; roughly a third are with FIs with $1 billion to $3 billion in assets; and 23% are from FIs with assets between $3 billion and $20 billion (Figure 1). One in five are chief executive officers and 38% are other C-level executives or executive VPs (Figure 2).

FIGURE 1: **Asset Distribution of Survey Participants**



Source: Cornerstone Advisors survey of 305 community-based financial institution executives, Q4 2018

FIGURE 2: **Titles of Survey Participants**



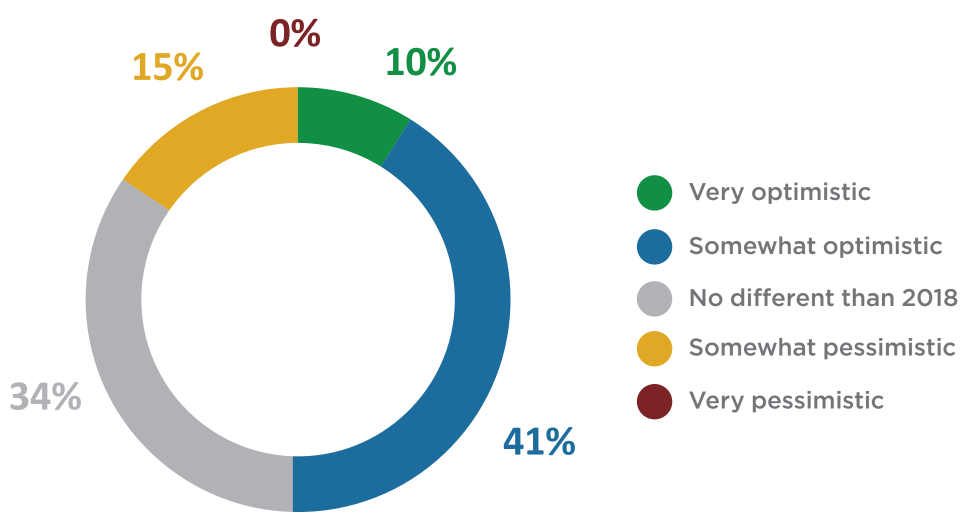
Source: Cornerstone Advisors survey of 305 community-based financial institution executives, Q4 2018

OPTIMISM

Compared to 2018, bank and credit union C-level execs are generally optimistic about 2019, with 10% very optimistic and another 41% feeling somewhat optimistic. None of the respondents said that they're very pessimistic, and just 15% said they're somewhat pessimistic (Figure 3).

FIGURE 3: **C-Level Outlook for 2019**

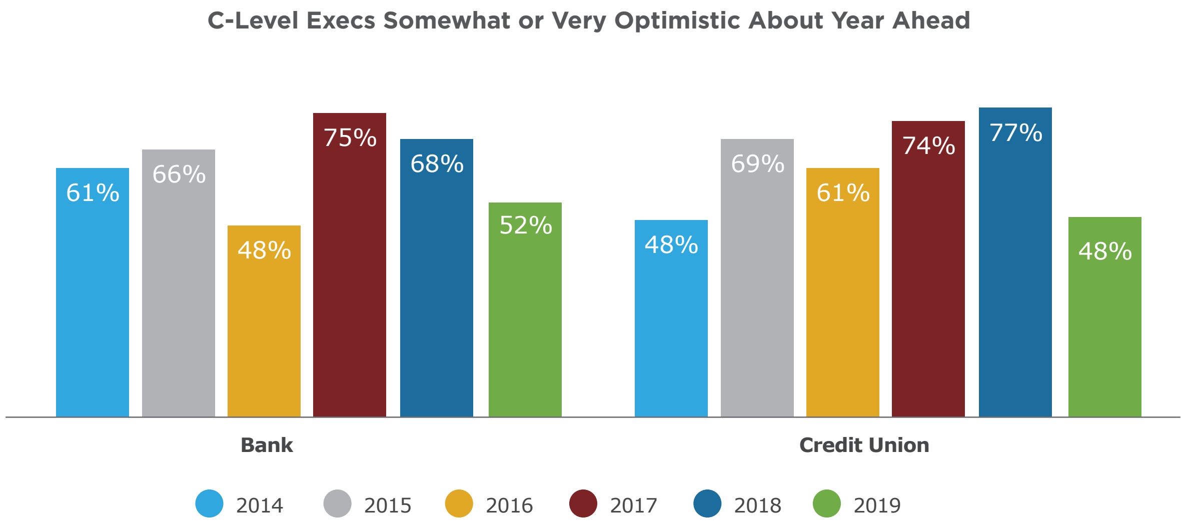
Compared to 2018, how optimistic are you about the banking industry in 2019?



Source: Cornerstone Advisors survey of 305 community-based financial institution executives, Q4 2018

Heading into 2019, optimism about the upcoming year took a dive, however, compared to previous years. Bank execs that are somewhat or very optimistic about the coming year dropped 16 percentage points in the latest survey, after a 7 point drop the previous year. On the credit union side, execs optimistic about the new year tumbled by nearly 30 percentage points (Figure 4).

FIGURE 4: **C-Level Outlook, 2014 to 2019**



Source: Cornerstone Advisors surveys of community-based financial institution executives, 2013-2018

Why the change in optimism? According to Cornerstone Advisors President and co-founder Steve Williams:

> *"The drop in optimism from executives picked up steam late in 2018, as the triple threat of slowing loan growth, higher funding costs and concerns of early credit softening translated to some of the most fragile forward earnings projections in years. The growing industry volatility is showing in the diminishing confidence banks and credit unions have in hitting earnings growth targets for 2019."*

Among survey respondents, optimistic executives had this to say:

> *"I'm somewhat optimistic because of the uptick in our local economy and the bank's adoption of new technologies."*
>
> **— Brian Thorguson,** Chief Operating Officer
> Patterson State Bank, Patterson, Louisiana ($221 million)

> *"I am optimistic about the banking industry in 2019 mostly because of the huge opportunity that digital innovations give institutions to serve their members and customers. It's an exciting time and it requires some out-of-box thinking and a leap of faith in order to move forward. I am also excited about the changing rate environment and the opportunities and challenges that come with it."*
>
> **— Jim Norris,** Chief Executive Officer
> Montgomery County Employees Federal Credit Union, Germantown, Maryland ($136 million)

"The opportunity ahead with all things digital expands the opportunity for community banks willing to shift and take advantage of it. It will require a very different approach than what banks have been used to, most likely different leadership, a different view on risk, more aggressive with technology, different people and different ways of thinking. If we get after it, the future is bright!"

— Kathy Strasser, Executive Vice President/COO
River Valley Bank, Wausau, Wisconsin ($1.3 billion)

"Provided the Fed stays the course and continues to raise rates and most economic metrics remain strong, next year should shape up fairly well."

— Tom Moran, Chief Executive Officer
Community Bank, Joseph, Oregon ($405 million)

"Our member loan demand remains strong and our net interest margin continues to improve. Recognize war for deposits to ease liquidity will tighten this margin as we have temporarily enjoyed loan rates rising faster than deposit rates. Investments in technology are paying off and we are able to sustain the pace of continued investment."

— Doug True, Chief Executive Officer
FORUM Credit Union, Fishers, Indiana ($1.4 billion)

"We have had campaigns to increase our membership and it's working to meet our goal at EOY. People are tired of paying fees just to have an account so they're looking for the best deal along with good service."

— Janie Schwartz-Shaw, Chief Compliance Officer
TDECU, Lake Jackson, Texas ($3.1 billion)

"Quality loan growth continues, and while interest rates are increasing, they are doing so at a measured pace."

— Bruno Sementilli, Chief Executive Officer
Quorum Federal Credit Union, Purchase, New York ($861 million)

"I am more optimistic about the industry because I feel that 2018 was a year for learning, ramping up and setting the foundation to move faster. I think that FIs know what they need to do to keep up, and now many are moving in that direction."

— Laura Thompson, Senior Vice President
Orange County's Credit Union, Santa Ana, California ($1.5 billion)

"I'm somewhat optimistic because the economy has not yet shown signs of slowing down. Unemployment is staying low for now, which gives consumers confidence to spend and borrow."

— Jennifer Burns, Director of Organizational Performance & Strategy
We Florida Financial, Margate, Florida ($524 million)

On the other side of the coin, execs explained their (somewhat) pessimistic position this way:

"Loan pricing and terms are beginning to remind us of 2006 as banks are concerned with market share. Margin compression will continue likely leading banks to become more aggressive with pricing and terms."

— Tim Ryan, Chief Financial Officer
Monona State Bank, Monona, Wisconsin ($864 million)

"Liquidity will become more challenging as rates continue to rise and savers increasingly seek higher yields, moving to money market funds and high yield savings accounts. More banks and credit unions will introduce online high yield offerings, increasing upward pressure on cost of funds. I'm also more concerned about household debt and the impact of a potential economic slowdown."

— David Mooney, Chief Executive Officer
Alliant Credit Union, Chicago, Illinois ($10 billion)

"Why pessimistic? Shrinking margins due to rising interest rates and reduced loan demand, along with increased cost of wages."

— Doug Ferraro, Chief Executive Officer
Bellco Credit Union, Greenwood Village, Colorado ($4.5 billion)

"I expect a slowdown in the economy and a resultant slowdown in lending during 2019. We have already seen a decline in mortgage loan applications due to interest rates."

— Jean Giard, Chief Executive Officer
Vermont Federal Credit Union, Burlington, Vermont ($510 million)

"Where we're at in the economic cycle, there's interest rate volatility, hyper competitive commercial and commercial real estate loan terms, and headwinds for fee income."

— Archie Brown, Chief Executive Officer
MainSource Bank, Greensburg, Indiana ($4.7 billion)

“Increasing probability of an economic slowdown in 2019-2020; significant increase in competition for deposits driving costs up; increasing competition in many lending sectors indicated by underpricing of credit risk; and exactly when is that regulatory relief going to show up???”

— Greg Gibson, Chief Financial Officer
Georgia’s Own Credit Union, Atlanta, Georgia ($2.3 billion)

“The level of competition on deposit rates and lack of growth will be a challenge to grow.”

— John Dwyer, Chief Executive Officer
New England Federal Credit Union, Williston, Vermont ($1.2 billion)

“I’m concerned that the Federal Reserve is moving too quickly to increase interest rates and as a result could push the economy into recession. I am also concerned about the squeeze the speed of the increases is having on margins.”

— Robert Glenn, Chief Executive Officer
Air Force Credit Union, San Antonio, Texas ($386 million)

“Economy and potential negative effect on loan quality and loan growth and also rising deposit rate costs.”

— Jack Clancy, Chief Executive Officer
Enterprise Bank, Lowell, Massachusetts ($2.9 billion)

“The expansion cycle is nearing its end. In addition to the normal economic cycle that suggests at least a slowdown if not a correction, there will be some significant economic headwinds from tariffs. The slowing housing sector and rising rates could slow loan demand, and the good economy that made many projects look attractive may prove somewhat illusory.”

— Robert Bradley, Chief Risk Officer
Bank of Tennessee, Kingsport, Tennessee ($1.3 billion)

“Reasons for pessimism: 1) Concern that Fed will raise rates beyond what is warranted, as it has so many times in the past; 2) Next Congress appears poised to ratchet the political ‘food-fight’ to a higher level rather than be prepared to address substantive economic and governance issues; 3) Emerging market weakness and geopolitical tensions continue to put a pall on the economy; 4) While capital levels are higher than 2006-2008, credit risk management discipline continues to slip.”

— Douglas N. Biddle, Chief Financial Officer
Bank of the Pacific, Aberdeen, Washington ($886 million)

CONCERNS

For this year's survey, we added "Growing deposits" to the list of concerns, which throws off the year-over-year comparison. We felt it was necessary, however, and that feeling was confirmed as it was the most-frequently mentioned concern among both bank and credit union executives.

Among bank respondents, the interest rate environment was the second-most frequently cited concern, in the top three for the second year in a row. Cybersecurity, which we asked about for the first time going into 2018, was among the top three concerns for 2019 for the second straight year (Table A).

TABLE A: **Bank Execs' Top Concerns, 2017-2019**

	2017	2018	2019
Growing deposits	NA	NA	50%
Interest rate environment	31%	46%	41%
Cybersecurity	NA	46%	34%
Cost of funds	14%	46%	29%
Weak economy/loan demand	19%	21%	25%
New customer/membership growth	NA	39%	24%
Regulatory burden	69%	29%	21%
Efficiency, non-interest expenses, or costs	61%	43%	19%
Non-interest income	33%	14%	13%

Source: Cornerstone Advisors surveys of community-based financial institution executives, Q4 2016, Q4 2017 and Q4 2018

TABLE B: **Credit Union Execs' Top Concerns, 2017-2019**

	2017	2018	2019
Growing deposits	NA	NA	54%
Interest rate environment	NA	27%	37%
Cybersecurity	52%	32%	34%
Cost of funds	NA	45%	33%
Weak economy/loan demand	52%	45%	24%
New customer/membership growth	28%	25%	24%
Regulatory burden	7%	39%	23%
Efficiency, non-interest expenses, or costs	51%	32%	20%
Non-interest income	35%	27%	14%

Source: Cornerstone Advisors surveys of community-based financial institution executives, Q4 2016, Q4 2017 and Q4 2018

SO WHAT

Banks and credit unions are feeling the impact of deposit displacement—the diversion, or displacement, of funds from traditional checking accounts to alternative accounts—as consumers put their money into health savings accounts, P2P payments tools like Venmo and Square Cash, savings tools like Acorns and Stash, and robo-advisor tools like Betterment. Bottom line: Checking accounts have become paycheck motels—temporary places for people's money to stay before it moves on to bigger and better places—making the goal of growing deposits more difficult than it was in the past.

GROWTH PRIORITIES

As they have been for the past two years, commercial loans and deposits are top growth priorities for bank CEOs for 2019 (Table C). Three big differences from last year: 1) The drop in the percentage of execs citing improvement of sales and marketing methods as a growth priority, as the focus shifts to expanding their digital presence; 2) Although just 18% cited small business as a Top 3 growth priority, that percentage is more than double what it was going into 2018; and 3) The doubling in the percentage citing mortgages as a growth priority.

TABLE C: **Banks' Growth Priorities, 2018-2019**

What are your financial institution's top growth priorities for the coming year?
(select up to three)

	2018	2019
Grow commercial loans	86%	60%
Grow commercial deposits	57%	56%
Grow consumer deposits	39%	46%
Expand digital presence (e.g., online and mobile channels)	18%	37%
Improve market share among the small business market	7%	18%
Improve sales and marketing methods/processes	36%	16%
Grow mortgage loans and/or mortgage originations	7%	15%
Grow wealth management, trust, insurance lines of business	18%	14%
Find good acquisition or merger targets/partners	11%	10%
Grow payments-related income	7%	6%
Grow consumer fee income	0%	6%
Grow consumer loans	4%	5%
Expand branch presence	11%	3%
Grow other non-traditional lines of business	0%	3%

Source: Cornerstone Advisors surveys of community-based financial institution executives, Q4 2017 and Q4 2018

Regarding their top concern, growing consumer deposits was the most frequently cited growth priority among credit union execs, and a significantly larger percentage than in the previous year will focus on growing commercial deposits (Table D). Consumer loans and mortgages will be top priorities for far fewer credit unions in 2019 than they were in 2018.

TABLE D: **Credit Unions' Growth Priorities, 2018-2019**

What are your financial institution's top growth priorities for the coming year?
(select up to three)

	2018	2019
Grow consumer deposits	45%	64%
Expand digital presence (e.g., online and mobile channels)	30%	49%
Grow consumer loans	66%	40%
Improve sales and marketing methods/processes	27%	28%
Grow commercial (business) loans	23%	24%
Grow mortgage loans and/or mortgage originations	52%	20%
Grow commercial deposits	2%	16%
Grow payments-related income	7%	13%
Expand branch presence	16%	11%
Grow consumer fee income	7%	10%
Find good acquisition or merger targets/partners	7%	7%
Improve market share among the small business market	7%	5%
Grow wealth management, trust, insurance lines of business	5%	4%
Grow other non-traditional lines of business	2%	2%

Source: Cornerstone Advisors surveys of community-based financial institution executives, Q4 2017 and Q4 2018

According to Cornerstone Advisors Managing Director Jim Burson:

> *"Deposit strategies must go beyond price. FIs should create offers that combine mobile information ad security with underlying money movement capabilities. In addition, sales and marketing capabilities are an essential part of having a digital presence. Without both, it's like using a toothbrush without toothpaste—it works, but it's not very effective."*

LENDING PRIORITIES

Already a top lending priority, even more banks will focus on commercial C&I loans in 2019 than they did in 2018. Small business loans were cited as a high priority for 2019 by nearly seven in 10 banks—up from 56% in 2018 (Table E).

TABLE E: **Banks' Loan Priorities, 2018-2019**

Q. To what extent were the following types of loans a priority in 2018, and will they be for 2019?

	PRIORITY	2018	2019
Commercial C&I loans	High	72%	77%
	Moderate	19%	14%
	Low	5%	6%
	Not offered	4%	3%
Commercial real estate loans	High	70%	65%
	Moderate	26%	30%
	Low	3%	4%
	Not offered	1%	1%
Small business loans	High	56%	68%
	Moderate	32%	24%
	Low	8%	7%
	Not offered	3%	2%
Consumer mortgages	High	35%	33%
	Moderate	46%	49%
	Low	16%	13%
	Not offered	3%	5%
Home equity loans/lines of credit	High	18%	22%
	Moderate	47%	45%
	Low	30%	27%
	Not offered	4%	5%
Loan participations	High	11%	14%
	Moderate	41%	37%
	Low	40%	41%
	Not offered	9%	7%
Consumer personal loans	High	5%	9%
	Moderate	28%	26%
	Low	59%	57%
	Not offered	9%	9%
Auto loans	High	5%	7%
	Moderate	20%	19%
	Low	60%	60%
	Not offered	14%	14%
Point-of-sale loans	High	3%	3%
	Moderate	3%	5%
	Low	25%	23%
	Not offered	69%	69%
Student loans	High	1%	2%
	Moderate	3%	3%
	Low	26%	22%
	Not offered	70%	73%

Source: Cornerstone Advisors surveys of community-based financial institution executives, Q4 2017 and Q4 2018

Mortgages may not be a Top 3 growth priority for credit unions, but they're still an important part of the loan portfolio. Although a priority for just a minority of credit unions, the percentage placing high priority on point-of-sale and student loans nearly doubled between 2018 and 2019 (Table F).

TABLE F: **Credit Unions' Loan Priorities, 2018-2019**

Q. To what extent were the following types of loans a priority in 2018, and will they be for 2019?

	PRIORITY	2018	2019
Consumer mortgages	High	60%	70%
	Moderate	35%	26%
	Low	5%	3%
	Not offered	0%	1%
Auto loans	High	63%	61%
	Moderate	29%	31%
	Low	7%	7%
	Not offered	1%	1%
Home equity loans/lines of credit	High	56%	60%
	Moderate	37%	36%
	Low	6%	4%
	Not offered	1%	0%
Consumer personal loans	High	47%	44%
	Moderate	36%	41%
	Low	17%	15%
	Not offered	0%	0%
Commercial real estate loans	High	32%	34%
	Moderate	29%	33%
	Low	15%	11%
	Not offered	24%	22%
Small business loans	High	22%	28%
	Moderate	27%	28%
	Low	22%	19%
	Not offered	29%	25%
Commercial C&I loans	High	14%	16%
	Moderate	15%	17%
	Low	26%	22%
	Not offered	45%	46%
Loan participations	High	10%	12%
	Moderate	34%	31%
	Low	38%	37%
	Not offered	18%	19%
Point-of-sale loans	High	7%	12%
	Moderate	18%	16%
	Low	26%	22%
	Not offered	49%	50%
Student loans	High	3%	6%
	Moderate	16%	17%
	Low	32%	32%
	Not offered	49%	45%

Source: Cornerstone Advisors surveys of community-based financial institution executives, Q4 2017 and Q4 2018

PAYMENTS PRIORITIES

The importance of treasury/cash management services makes a big jump in 2019, as the percentage of banks considering it a high priority increased from 52% to 72% (Table G). According to Cornerstone Advisors' Burson:

> *"Hand in hand with the need for deposits is the need to improve treasury offerings, which will put downward pressure on fee income tied to these services as competition heats up in the quest for liquidity."*

TABLE G: **Banks' Payments Priorities, 2018-2019**

Q. To what extent were the following payments products/tools a priority in 2018, and will they be for 2019?

	PRIORITY	2018	2019
Treasury/cash management	High	52%	72%
	Moderate	32%	18%
	Low	11%	3%
	Not offered	5%	6%
Debit cards	High	52%	62%
	Moderate	32%	31%
	Low	14%	5%
	Not offered	2%	2%
Mobile bill pay	High	20%	32%
	Moderate	47%	50%
	Low	31%	16%
	Not offered	2%	2%
Mobile payment tools	High	18%	30%
	Moderate	34%	42%
	Low	31%	19%
	Not offered	18%	10%
Credit cards	High	20%	29%
	Moderate	20%	26%
	Low	41%	29%
	Not offered	19%	17%
Mobile wallets	High	9%	27%
	Moderate	35%	34%
	Low	33%	24%
	Not offered	23%	15%
Purchasing cards (p-cards)	High	5%	11%
	Moderate	18%	19%
	Low	27%	22%
	Not offered	50%	47%
Prepaid cards	High	1%	2%
	Moderate	5%	6%
	Low	38%	36%
	Not offered	57%	57%

Source: Cornerstone Advisors surveys of community-based financial institution executives, Q4 2017 and Q4 2018

Reflecting the change in consumers' payments habits, three-quarters of credit unions will place a high priority on growing their credit card portfolios in 2019, up from 56% in 2018 (Table H).

TABLE H: **Credit Unions' Payments Priorities, 2018-2019**

Q. To what extent were the following payments products/tools a priority in 2018, and will they be for 2019?

	PRIORITY	2018	2019
Credit cards	High	56%	74%
	Moderate	26%	17%
	Low	15%	7%
	Not offered	3%	3%
Debit cards	High	61%	71%
	Moderate	28%	25%
	Low	12%	4%
	Not offered	0%	0%
Mobile bill pay	High	19%	28%
	Moderate	42%	46%
	Low	35%	24%
	Not offered	5%	3%
Mobile payment tools	High	11%	20%
	Moderate	37%	47%
	Low	43%	27%
	Not offered	8%	6%
Mobile wallets	High	9%	17%
	Moderate	30%	41%
	Low	47%	37%
	Not offered	15%	5%
Treasury/cash management services	High	4%	11%
	Moderate	10%	11%
	Low	18%	18%
	Not offered	68%	60%
Purchasing cards (p-cards) and other commercial cards	High	0%	3%
	Moderate	3%	5%
	Low	19%	14%
	Not offered	79%	79%
Prepaid cards	High	0%	2%
	Moderate	2%	4%
	Low	42%	42%
	Not offered	56%	52%

Source: Cornerstone Advisors surveys of community-based financial institution executives, Q4 2017 and Q4 2018

SO WHAT

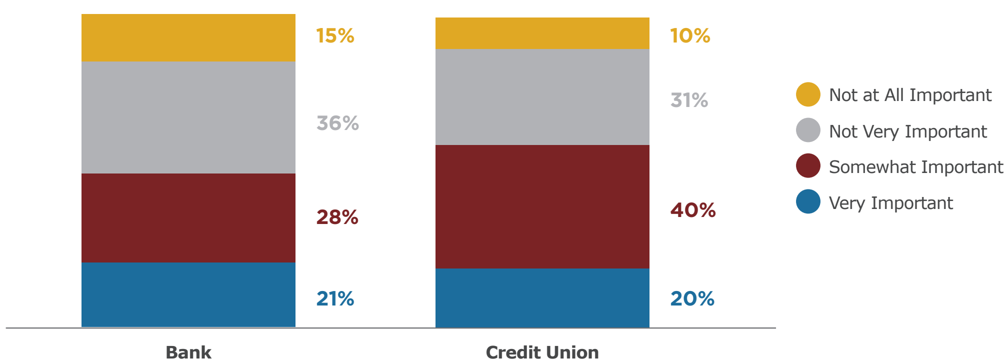
Banks want consumer deposits—but not consumer loans. Many banks are missing the potential connection here. Growing consumer relationships through lending products that bring deposits with them—through bundling or pricing incentives—is a successful strategy in a number of banks.

FINTECH

Six in 10 credit union and half of bank executives said fintech partnerships, collaborations and/or investments will be very or somewhat important to them in 2019 (Figure 5).[1]

FIGURE 5: **Importance of Fintech Partnerships**

How important will fintech partnerships, collaborations and/or investments be to your organization in 2019?

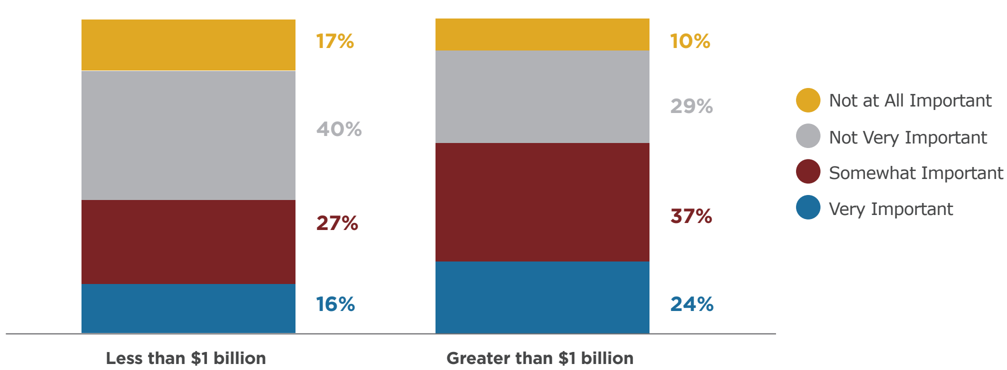


Source: Cornerstone Advisors survey of 305 community-based financial institution executives, Q4 2018

Generally speaking, fintech partnerships will be of more importance to larger institutions (more than $1 billion in assets) than smaller ones (Figure 6).

FIGURE 6: **Importance of Fintech Partnerships by Asset Size**

How important will fintech partnerships, collaborations and/or investments be to your organization in 2019?



Source: Cornerstone Advisors survey of 305 community-based financial institution executives, Q4 2018

[1] We instructed survey respondents to think of "fintechs" as startups in the financial space—either B2C-focused like Chime, Digit and Lending Club, or B2B-focused like Abe AI and Personetics—and not established vendors like FIS, Fiserv and Jack Henry.

Where are banks and credit unions planning to focus their fintech-related efforts? Digital account opening, payments and lending/credit are at the top of both types of institutions' lists. One surprising difference: A third of banks cited new banking products as a priority in contrast to just one in five credit unions (Table I, Table J).

TABLE I: **Banks' Fintech Functional Priorities**

Q. How important are the following functional/product areas to your fintech partnership, collaboration and/or investment plans for 2019?

	Very important	Somewhat important	Not very important	Not at all important
Digital account opening	70%	26%	2%	2%
Payments	53%	37%	5%	5%
Lending and credit	48%	45%	7%	0%
Fraud/risk management	35%	51%	11%	4%
New banking products	34%	50%	14%	2%
Personal financial management	20%	51%	21%	8%
Investment management	16%	36%	34%	14%
Insurance	9%	12%	31%	48%
International remittances	3%	10%	29%	57%

Source: Cornerstone Advisors survey of 305 community-based financial institution executives, Q4 2018

TABLE J: **Credit Unions' Fintech Functional Priorities**

Q. How important are the following functional/product areas to your fintech partnership, collaboration and/or investment plans for 2019?

	Very important	Somewhat important	Not very important	Not at all important
Digital account opening	76%	23%	1%	0%
Lending and credit	56%	34%	9%	1%
Payments	54%	42%	4%	0%
Fraud/risk management	42%	45%	11%	1%
New banking products	20%	55%	25%	0%
Personal financial management	17%	65%	16%	1%
Investment management	4%	41%	36%	19%
Insurance	3%	29%	44%	24%
International remittances	1%	7%	37%	55%

Source: Cornerstone Advisors survey of 305 community-based financial institution executives, Q4 2018

We can't say we were very surprised to see "improve the customer experience" at the top of banks' and credit unions' lists of fintech business objectives. We were surprised, however, that a larger percentage of credit unions cited expense reduction as an objective (Table K, Table L).

TABLE K: **Banks' Fintech Business Objectives**

Q. Regarding your plans for fintech partnerships, collaborations and/or investments for 2019, how important are the following business objectives?

	Very important	Somewhat important	Not very important	Not at all important
Improve the customer experience	82%	16%	2%	0%
Create new capabilities or competencies	58%	35%	6%	1%
Strengthen core competencies/competitive positions	55%	39%	6%	0%
Reduce operating expenses	38%	48%	12%	2%
Reduce fraud	37%	51%	13%	0%
Expand product line	36%	51%	13%	1%
Reach new consumer segments	30%	49%	16%	5%
Expand geographic reach	17%	39%	39%	5%

Source: Cornerstone Advisors survey of 305 community-based financial institution executives, Q4 2018

TABLE L: **Credit Unions' Fintech Business Objectives**

Q. Regarding your plans for fintech partnerships, collaborations and/or investments for 2019, how important are the following business objectives?

	Very important	Somewhat important	Not very important	Not at all important
Improve the customer experience	90%	8%	1%	0%
Create new capabilities or competencies	52%	46%	1%	0%
Strengthen core competencies/competitive positions	51%	44%	6%	0%
Reduce operating expenses	46%	46%	7%	0%
Reduce fraud	39%	48%	13%	0%
Reach new consumer segments	34%	53%	13%	0%
Expand product line	28%	58%	14%	0%
Expand geographic reach	21%	48%	23%	8%

Source: Cornerstone Advisors survey of 305 community-based financial institution executives, Q4 2018

According to Cornerstone Advisors Partner Terence Roche:

> *"It's good that the top fintech investment focus is digital account opening. But if FIs believe that digital account opening will be the driver of deposit growth—that's only partially correct. If their view of digital account opening is 'opening' and doesn't include a hefty focus on digital marketing, contextual product offerings, data-driven campaigns and a very tight, easy fulfillment process (i.e., the marketing tool is very tightly integrated with the fulfillment tool, or they are one tool), then it won't matter what investment they make. It won't work."*

SO WHAT

Many financial institutions are deceiving themselves if they think they can get into fintech partnerships without the right skill sets to identify partnership priorities, vet potential partners, and negotiate terms. Mid-size financial institutions are used to managing vendors—not partners. Getting into fintech partnerships requires FIs to be able to answer these questions:

- Where are the biggest opportunities from a market perspective?
- Which value creation strategies have the best opportunities of success?
- Which value creation strategies best align with the organization's strategy?
- Which value creation strategies best align with the organization's capabilities?
- Which potential partners have the best prospects for success?
- Which potential partners would actually make good partners?

We simply don't believe that half of FIs can answer these questions.

FUTURE READINESS

For the third straight year, we asked bank and credit union executives to rate the future-readiness of their organizations. Among bank executives, the information technology function was rated somewhat or very future-ready by nearly two-thirds of respondents. Commercial lending and treasury/cash management both saw significant increases in future-ready assessments from last year's survey. Marketing was also rated as significantly more future-ready than last year—why, we have no idea (Table M).

TABLE M: **Banks' Future-Readiness**

Percentage of Executives Rating Function as Somewhat or Very Future-Ready

	2017	2018	2019
IT	51%	61%	63%
Fraud/risk management	43%	47%	56%
Digital banking	54%	54%	55%
Commercial lending	NA	38%	46%
Treasury/cash management	NA	34%	46%
Payments	42%	44%	44%
Marketing	36%	36%	44%
Branch delivery	33%	30%	34%
Contact center	24%	23%	28%
Analytics	21%	19%	21%

Source: Cornerstone Advisors surveys of community-based financial institution executives, Q4 2016, Q4 2017 and Q4 2018

In contrast, credit union execs rated digital banking their most future-ready function, with a big jump in 2019 after a big decline in 2018. IT, fraud/risk management, and the contact center also saw increases in future-readiness assessment (Table N).

TABLE N: **Credit Unions' Future-Readiness**

Percentage of Executives Rating Function as Somewhat or Very Future-Ready

	2017	2018	2019
Digital banking	61%	51%	63%
IT	51%	46%	56%
Fraud/risk management	37%	41%	52%
Marketing	55%	43%	47%
Branch delivery	50%	39%	39%
Contact center	39%	29%	37%
Payments	42%	38%	32%
Analytics	25%	24%	22%
Commercial lending	NA	17%	9%
Treasury/cash management	NA	16%	9%

Source: Cornerstone Advisors surveys of community-based financial institution executives, Q4 2016, Q4 2017 and Q4 2018

SO WHAT

Going into 2017, we chided FI execs for being too optimistic about the future-readiness of their operations. In 2018, we saw a more sobering view, particularly among credit union execs whose future-ready assessments declined in seven of the eight functions we asked about. The past year (2018) must have been a productive one as future-ready ratings from both bank and credit union execs improved in most categories. Considering the slow uptake of emerging technologies (see the next section), we can't help but think many executives are deceiving themselves.

EMERGING TECHNOLOGIES

A year ago, when we conducted the survey for the *What's Going On In Banking 2018* study, few banks had deployed emerging technologies, and few had plans to do so in 2018. The upcoming year (2019) may see a bit more activity (but still not much). One in five banks plans to invest in video collaboration tools in 2019, and roughly one in 10 plans to deploy chatbots or other artificial intelligence technologies (Table O).

TABLE O: **Banks' Emerging Technology Plans for 2019**

	Have already deployed	Planning to invest and/or implement in 2019	Have discussed at board or exec team level	Not on the radar
Video collaboration/marketing	14%	20%	38%	27%
Robotic process automation	6%	7%	24%	63%
Chatbots	2%	11%	41%	47%
Machine learning	2%	8%	32%	58%
Blockchain	2%	1%	33%	65%
Artificial intelligence	1%	10%	40%	49%

Source: Cornerstone Advisors survey of 305 community-based financial institution executives, Q4 2018

Credit unions, on the other hand, appear to be poised to start experimenting with a range of emerging technologies. Nearly three in 10 plan to invest in video collaboration technology, with nearly one in five looking to invest in AI or machine learning. In addition, 10% of credit union execs said they're planning to invest in blockchain in 2019 (Table P).

TABLE P: **Credit Unions' Emerging Technology Plans for 2019**

	Have already deployed	Planning to invest and/or implement in 2019	Have discussed at board or exec team level	Not on the radar
Video collaboration/marketing	12%	29%	38%	21%
Artificial intelligence	4%	17%	50%	28%
Chatbots	3%	15%	50%	31%
Machine learning	3%	19%	40%	38%
Robotic process automation	1%	6%	42%	51%
Blockchain	0%	10%	57%	33%

Source: Cornerstone Advisors survey of 305 community-based financial institution executives, Q4 2018

SO WHAT

Coffee-table books are there to generate conversation, and it looks like that's mostly what's happening with emerging technologies like AI, machine learning and RPA. Most of the activity regarding these technologies involves discussions at the board or executive team level. We suspect that many execs simply don't know what they have as RPA has been embedded in apps for years.

TECHNOLOGY PLANS AND SPENDING

We asked survey respondents about their plans to modify or improve, or add new or replacement systems for 44 technologies, covering nine areas of the organization (Table Q):

- **Consumer digital.** Digital account opening will be a top focus for new and replacement systems again in 2019, as will P2P payments, which more than a third of FIs said they'll be adding or replacing in 2019.

- **Channels.** We had to double check the data to make sure that the doubling in the percentage of FIs planning to add or replace their new account/teller systems was right. It's right. According to Cornerstone Advisors Senior Director Sam Kilmer:

  > *"Increasingly, banks are looking to consolidate into one (or at least coordinate) those digital and branch account opening systems or decisions. Meanwhile, the supplier market for buyers is rapidly mashing up (e.g., Jack Henry/BOLTS, Q2/Gro, Meridianlink/CRIF, Temenos/Avoka). In total, the market lacks confidence in the ability to grow customers while they are seen less frequently. It translates into system changes, but the need for internal talent is also acute."*

- **Commercial digital.** Reflecting the increase in the percentage of banks that said treasury and cash management services were a payments priority, a growing number of banks will be looking to enhance their technology capabilities in these areas.

- **Lending.** Anticipating an end to the lending party in 2019, fewer banks will be enhancing or adding new lending systems in 2019 compared to 2018.

- **IT.** We added cloud applications to the list of IT technologies we track, and it's a good thing we did, as it is the top IT-related technology that financial institutions will add or replace in 2019. According to Quintin Sykes, managing director at Cornerstone Advisors:

  > *"Thanks to continued deployments of cloud-based CRM, loan origination and other business applications, financial institutions continue to gain comfort with hosting non-public personal information in the cloud. Use of private clouds such as Microsoft Azure and Amazon Web Services to host licensed applications will continue to increase as financial institutions push hosting out of their owned/leased data centers. For those that don't already have them on staff or via a partner, cloud deployment/integration skills will become a 'must-have' for CIOs this year."*

- **Marketing.** It appears some FIs are just giving up on trying to improve their existing CRM apps and, instead, will look for new systems in 2019.

- **Analytics.** This is the first year we looked specifically at a few analytics technologies, and it's a good thing we did—roughly half of FIs will be enhancing their reporting/dashboard and fraud/risk analysis apps in 2019.

- **Business functions.** A lessening focus on reducing paper means fewer FIs will be looking to enhance their document imaging systems in 2019.

- **Payments.** Reflecting the increased importance of credit cards to FIs' payments strategies, fewer will look to improve their existing credit card processing capabilities and instead will look for new or replacement providers in 2019.

TABLE Q: **Banks' and Credit Unions' Technology Plans for 2019**

		Modify/Improve			Add New or Replace		
		2017	2018	2019	2017	2018	2019
Consumer Digital	Digital account opening	38%	43%	39%	29%	28%	36%
	Person-to-person payments	NA	NA	25%	NA	NA	35%
	Mobile banking	48%	52%	46%	13%	15%	19%
	Online banking	45%	48%	48%	13%	15%	17%
	Personal financial management	17%	19%	19%	16%	17%	14%
	Digital bill payment	26%	24%	29%	12%	15%	12%
	Remote deposit capture	23%	24%	27%	11%	11%	11%
Commercial Digital	Commercial online banking	29%	29%	25%	18%	17%	17%
	Commercial mobile banking	24%	25%	28%	22%	19%	16%
	Treasury/cash management	NA	18%	27%	NA	14%	11%
	Commercial remote deposit capture	17%	13%	21%	15%	14%	11%
Lending	Commercial loan origination system	29%	34%	26%	22%	13%	23%
	Online LOS	33%	37%	38%	14%	19%	18%
	Consumer LOS	30%	29%	34%	20%	23%	17%
	Mortgage LOS	25%	45%	29%	15%	20%	15%
	Loan stress testing	23%	19%	25%	11%	10%	10%
Channels	New account/teller system	29%	23%	14%	10%	13%	25%
	Interactive teller system	15%	23%	19%	21%	19%	17%
	Call center system	37%	38%	38%	10%	12%	10%
	Teller capture	15%	12%	19%	13%	15%	9%
	Branch capture	18%	19%	19%	5%	8%	4%
IT	Cloud application deployment	NA	NA	24%	NA	NA	16%
	Core processing system	22%	23%	19%	11%	9%	9%
	Network/server virtualization	52%	45%	42%	13%	9%	8%
	Telecom/datacom	31%	26%	28%	12%	10%	8%
	IT service management tools	NA	NA	30%	NA	NA	8%
	Vendor management	23%	28%	26%	6%	5%	7%
Marketing	Customer relationship management	42%	40%	32%	19%	21%	25%
	Marketing automation	27%	40%	32%	15%	16%	16%
	Profitability/pricing	20%	27%	29%	12%	13%	9%
Analytics	Reporting/dashboard	NA	NA	52%	NA	NA	16%
	Data warehouse	NA	NA	39%	NA	NA	15%
	Data analysis/business intelligence (BI)	NA	NA	41%	NA	NA	15%
	Predictive analytics	NA	NA	35%	NA	NA	15%
	Fraud/risk analysis	NA	NA	50%	NA	NA	12%
Business Functions	Document imaging/workflow	44%	47%	36%	12%	11%	12%
	Fraud management	39%	41%	44%	14%	11%	10%
	Enterprise risk management	29%	31%	33%	9%	9%	10%
	Asset liability management	15%	14%	18%	11%	5%	6%
Payments	Debit card processing	NA	19%	18%	NA	12%	12%
	Credit card processing	NA	20%	13%	NA	8%	12%
	Card self-service	NA	NA	23%	NA	NA	11%
	ATM processing	NA	19%	22%	NA	9%	10%
	ACH origination	30%	26%	28%	7%	6%	7%
	Wire automation	23%	23%	20%	10%	8%	6%

Top 5

Source: Cornerstone Advisors survey of 305 community-based financial institution executives, Q4 2018

TECH SPENDING

Eighty-seven percent of financial institutions will increase tech spending in 2019 from 2018 levels, and in about one-fourth of them, spending will rise by more than 10% (Table R).

TABLE R: **Banks' and Credit Unions' Technology Spending Change**

How will your institution's tech spending change in 2019 compared to 2018?

	BANKS		CREDIT UNIONS	
	2018	2019	2018	2019
Significantly higher (>10% higher)	22%	26%	30%	25%
Somewhat higher (1%-10% higher)	63%	59%	54%	66%
No change	9%	12%	9%	7%
Somewhat lower (1%-10% lower)	4%	2%	6%	2%
Significantly lower (>10% lower)	1%	1%	0%	0%

Source: Cornerstone Advisors surveys of community-based financial institution executives, Q4 2017 and Q4 2018

FINAL WORDS

I hope I'm wrong about this, but 2019 is shaping up to be a challenging year for the banking industry. The regulatory changes that FIs expected to see after the 2016 presidential election never really materialized, and with the Democratic takeover of the House in the 2018 mid-term election, banking-unfriendly politicians will re-occupy the banking committee.

In addition, despite a bunch of positive economic indicators—including unemployment and wages—the downward trend in the stock market is causing concern. Interest rates are poised to rise (finally), making liquidity difficult and putting upward pressure on banks' cost of funds. Credit card default rates are increasing, in particular for mid-size issuers.

And while the threat of fintech disruptors has morphed into the promise of fintech partnerships, let's be realistic: Few mid-size FIs have the resources and skills to enter into more than one or two partnerships, and even those partnerships aren't likely to produce significant benefits in 2019.

I hope to tell you that I was wrong in next year's *What's Going On In Banking 2020* report.

Ron Shevlin
Director of Research
Cornerstone Advisors

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