Retail Banking At The Turn Of The Decade

Where we've come from and where we're going

REPORT

Index

Introduction

Part 1

The 2010s in retrospect 4

The fallout from the 2008 financial crisis. 4

The European second wave. 4

Plummeting interest rates. 5

The perfect storm of choice, technology, and outrage. 6

Part 2

Where does this leave banking in the new decade? 8

The rise of the neobanks and other fintechs. 8

The entry of tech giants into banking. 8

Changing demographics. 9

Part 3

How can retail banking survive (and thrive) in the 2020s? 11

Building long term relationships with the younger demographic. 11

Use tech to customize the user experience. 12

Taking advantage of their data-rich position. 13

Leverage Open Banking to be at the center of the client's global financial picture. 14

Part 4

In 10 years, what will banking look like? 16

Conclusion

Introduction

Consumer banking at the turn of the decade

During the past decade, the retail financial services service sector underwent an unprecedented change. Although some of this transformation came from within, external factors played an outsized role in redefining banking. These changes culminated in an operating environment that today is mostly unknown to traditional banks.

Ten years ago, the economy in general, and banks, in particular, were wounded from a prolonged financial crisis. The widespread outrage in its aftermath inspired governments and entrepreneurs alike to fix the system and innovate it simultaneously. One of the outcomes was an explosion of 'Fintech' startups, which in turn set the stage for Open Banking to emerge in the mid 2010's. The Open Banking movement, coupled with extraordinary technological advancements, has disrupted consumer financial services profoundly. If that wasn't enough, the population makeup continues to shift, adding yet another dimension to the challenges banks face.

As we enter into the third decade of this century, we believe that it is vital to assess the changes that occurred in retail banking in the 2010s, take stock of where we are now and lay out a vision for the 2020s. Our report explores how we got to this point, what position retail banks find themselves in, and what actions they must take to remain relevant in the 2020s.

Part 1

The 2010s in retrospect

The fallout from the 2008 financial crisis

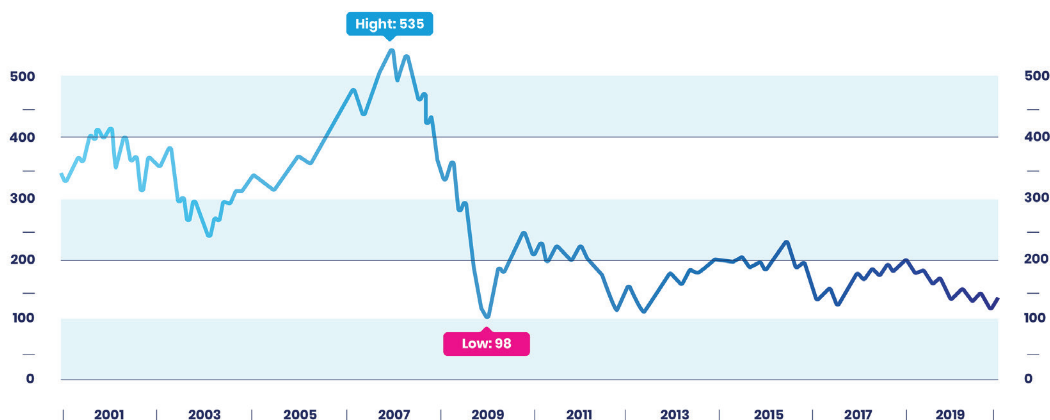
While the biggest financial crisis of the century (so far) happened in the first decade, its effects rippled well into the 2010s. The global impact of the meltdown of the US banking system quickly spread across the world. In its wake, once-mighty institutions like Lehman Brothers, Bear Stearns, and AIG were either decimated or liquidated. The surviving firms were left holding complex derivatives worth little more than the paper their prospectuses were printed on.

Dozens of factors set the stage for the crisis, but one thing is certain about its outcome: in its aftermath, the banks received hundreds of billions in bailouts while consumers got left holding the bill in the form of budgets cuts to social spending. The resulting outrage fueled the "Occupy Wall Street" movement in 2011, setting the tone for consumer attitudes towards banks for the rest of the decade, as well as giving fodder to regulators and governments to institute reform.

The European second wave

The initial effects of the financial crisis hit American banks the hardest. Foreign investors, including banks, pension funds, and insurers, all tried to cut their losses and retreat to various havens.

Unfortunately for foreign institutions, that refuge was short-lived with a new tidal wave landing a direct hit on European banks. The Spanish banking system, like the American one, drowned in toxic mortgages. Portugal nearly became insolvent, and Ireland was in the depths of a great recession. Banks in Belgium, Germany, Luxembourg, the UK, and the Netherlands needed bailouts. This domino effect carried into the 2010s.



Finally, years of lax fiscal policy caught up with Greece, creating a credit crisis in Europe that many believed to be a relic of the last century. As Greece could not cover its debts, the Euro started to face an existential threat. When the dust settled at the end of the decade, the fabric of European banking was tattered. Banks, particularly the ones in Europe, have yet to recover their position fully. As of early 2020, the Stoxx 600 Banks index of the continent's 45 largest banks is at a quarter of its 2007 high.[1]

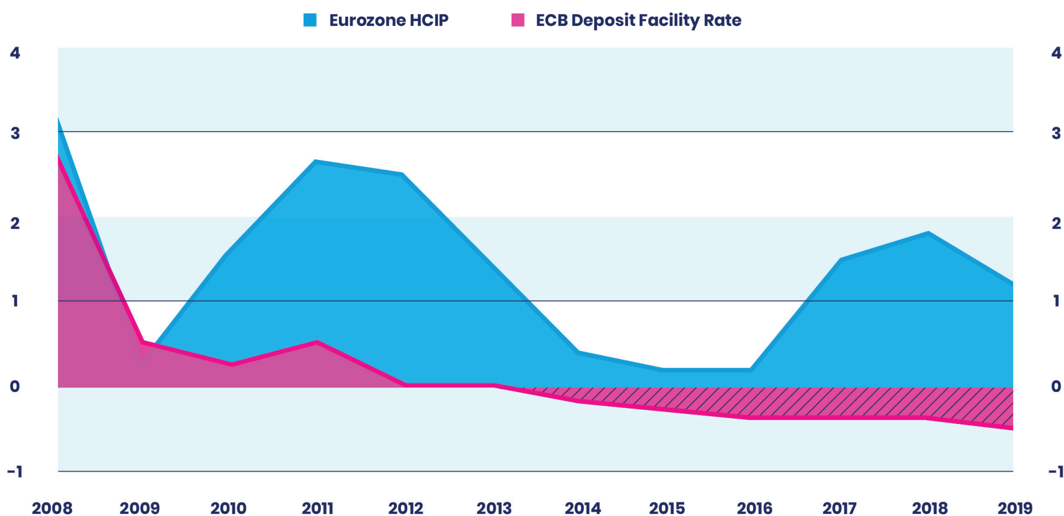
Plummeting interest rates

The resulting recessions from the financial crisis put pressure on governments and central banks to act. Governments began propping up banks with bailouts and moderately increasing spending to stimulate their ailing economies.

Central banks enacted fiscal policies that would both help the financial sector and encourage spending. To achieve the latter, they embarked on an era of interest rate-cutting that continued throughout the decade.

The effects on the economy meant lower borrowing rates. The cuts hit consumer lending directly, with mortgage rates now at historic lows. For borrowers, these historically low rates are a boon, with cheap credit abundantly available. For retail banks writing the loans, the situation is less pleasant.

Lending is a core revenue driver for all banks. For retail banks, mortgages represent an outsized portion of their balance sheet. As rates dropped, the yield generated by loans fell accordingly. Today, many mortgages are financed well below the inflation rate in the Eurozone. Over the next coming decades, banks will feel even more pressure to find alternative revenue sources to offset lower yields.



Dropping central bank interest rates versus inflation in the Eurozone from 2008 until 2019.[2]

1. Stoxx Qontigo Market Data
2. ECB Statistical Data Warehouse & Eurostat data

The perfect storm of choice, technology, and outrage

The wake of the financial crisis laid bare not only the inherent weaknesses of the global banking system, but also the overwhelming consumer demand for better, cheaper, and more transparent financial services. Coincidentally at this time, smartphones and social media began to flood the market. Coupled with advances in internet technology, mass disruption in the financial services industry was inevitable.

While financial technology (fintech) had been around for some time, IT limitations restricted its use. However, the arrival of mobile browsing and new web standards such as Bootstrap, along with the rise of APIs opened up a Pandora's box of possibilities. As global outrage at the established financial system grew, entrepreneurs leveraged this new tech to reimagine consumer financial services and meet the demands of Millennials and Gen X.

The resulting output was phenomenal. "Robo" financial advisers, online low-cost currency exchange services, neobanks, peer-to-peer lenders, even cryptocurrencies all saw their birth and growth in the 2010s. Not to be outdone, banks also developed their apps and streamlined their online portals to meet growing consumer demand for these channels. Now, for the first time in modern history, consumers were getting viable alternatives to traditional retail banks.

Concurrently, the Open Banking movement began to take shape. The concept was simple: banks hold reams of user data and have APIs. By opening that data up to whoever wants it, fintech firms could create new, previously unimagined products and services, such as financial data analysis and transaction processing.

As the decade rolled on, consumers continued to pour their trust into these platforms. What began as an adventurous exercise by a handful of tech-inclined entrepreneurs became a movement in and of itself. Regulators around the world started to take note.

In 2015, the EU released its second payment services directive (PSD2), creating the legal framework for Open Banking across the bloc. Meanwhile, in the United Kingdom, regulators there went a step further. Their Open Banking model opened up the nine largest banks' user data[3], pushing the UK to the forefront of the movement.

Other parts of the world also saw Open Banking come into prominence. In the United States, the movement grew organically, with regulators taking a backseat to the fintechs' and banks' push for innovation[4]. Across Asia, leading financial centers took various steps to open banking data to third parties. In Singapore, the market regulator created guidelines for API development. Meanwhile, in Hong Kong, the authorities launched a four-pronged regulatory initiative to open up the retail banking sector.[5]

3. What is Open Banking? (OpenBanking.org.uk)
4. Which countries lead in open banking? (The Banker)
5. The Asia-Pacific way of Open Banking regulation (Finextra)

Japanese regulators made it mandatory for banks to publish their API policies while encouraging established firms to connect to at least one third-party provider by 2020. Finally, in Australia, new data protection laws pushed banks to innovate and align their tech models in an outward-facing way. [6]With other countries around the world following suit, either through regulation or a lack thereof, Open Banking came of age during the 2010s.

Coming into 2020, banks, particularly the ones in Europe, are battered and bruised. While their American counterparts have done well financially post-crisis, the sector's reputation is still scarred, particularly among the younger generations. In addition to Open Banking, other factors have emerged that pose an existential threat to banks.

6. Open Banking around the world - Towards a cross-industry data sharing ecosystem (Deloitte)

Part 2

Where does this leave banking in the new decade?

The rise of the neobanks and other fintechs

Neobanks, digital-only banks with low fees and intuitive interfaces, made their first meaningful impact on the retail banking industry in the 2010s. These companies, such as N26, Revolut, and Monzo, look to disrupt traditional banking by reimagining banking services from a customer-first viewpoint. Using the power of algorithms, they help their clients stay on top of their finances with budgeting and management tools.

While neobanks haven't (yet) entered the direct lending business that traditional banks rely on, their rise is indisputable. At the start of the decade, only six neobanks were in existence globally. By the end of 2019, that number sat at 45. Additionally, user penetration will continue to grow, with 20% of all European consumers expected to be using a neobank by 2023.[7]

In addition to neobanks, other fintech startups emerged in the 2010s. These upstart companies look to disrupt specific silos of a bank's business, using tech and a lean operating model to do so. The services targeted include more lucrative parts of retail banking's product line, including currency transfers, insurance writing, lending, and payments. Like their neobank cousins, these fintechs also technology to improve the overall user experience via superior apps and online interfaces.

Neobanks and fintechs also target small and medium-sized businesses, representing a further threat to yet another traditional retail banking business line. Together, the next decade will force traditional financial institutions to react to the growing popularity of digital banking alternatives.

The entry of tech giants into banking

The 2010s saw some of the biggest tech companies on the planet cement their global dominance. In fact, the Big Four tech companies (Google, Amazon, Facebook, and Apple) all grew their balance sheets and user base at a breakneck pace. These firms will continue to enrich their ecosystems in the 2020s, luring users to stay on their platform and either spend more money with them or provide more valuable marketing data to advertisers. To entice users to do so, the Big Four are all incorporating financial services into their product suite.

7. Neobanks: A Global Deep Dive (Medici Research)

Both Google and Apple allow users to link their profile with a bank account or credit card. Using either Google Wallet or Apple Pay, a customer of these platforms can quickly pay for purchases, only needing to validate their account details and not those of their bank's. This functionality isn't limited to the digital realm. Many merchants and payment service providers accept these "eWallets" as payment for physical transactions. E-commerce behemoth Amazon is also getting in on the act with their Amazon Pay product.

The benefit of these to these giants is clear. When users make a transaction using their eWallet, the eWallet issuer gains access to a trove of data. That information lets the eWallet issuer either directly suggest products, or pass it on to marketers wanting to do the same. Losing out on this data collection is a substantial disadvantage for banks.

At the very end of the 2010s, Facebook decided to enter into the fray, albeit with a slightly different approach. Facebook's Libra is a proposed cryptocurrency meant to facilitate cross-border payments. This ambitious program looks to leverage blockchain technology pioneered in the last decade to create a unified global currency for payments and money transfers. As of this writing, Facebook has yet to launch Libra. However, if successful, its threat to banking in the 2020s cannot be underestimated.

Changing demographics

The 2010s witnessed a prominent shift in the global population's composition, posing a significant hurdle for retail banks. Baby boomers have now begun to reach the end of their careers. As they retire, their banking needs will shift from wealth growth to wealth preservation, with little need for financing. Generation X, those born between 1964 and 1980, are at their earning prime right now. They spent the past decade, increasing their income while their children went from teenagers to young adults.

The Millennials, also known as Generation Y and which includes people born from 1981 until 1995, were one of the most profoundly impacted groups from the financial crisis.[8] At the beginning of the 2010s, Millennials were either just starting their careers or had only a few years of work experience under their belts. The resulting fallout has left them with relatively lower salaries and fewer savings compared to older generations. It was their skepticism, along with their tech fluency, that helped fuel the rise of fintech in the 2010s.

Finally, the oldest members of Generation Z are about to enter the workforce. These youths, the youngest born in 2012, are the first generation to only know a digital world, with the lines between virtual and reality blurred in their minds. Their social interactions happen online more than they happen in person. Crucially, they will be the next generation to need banking services as they are mostly unbanked at the turn of the decade.

8. The financial crisis may have scarred a generation for life (Quartz)

For banks, each one of these demographics views their relationship with financial service providers differently. Each generation has varying demands for the way they interact with both tech in general and banks in particular. Going into the 2020s, financial institutions wanting to remain relevant with these different age groups face a juggling act of generational proportions.

	Primary banking goals	Communication channel	Best pathway to loyalty
Silent Generation	Wealth preservation.	Face-to-face interactions.	Formal interactions that speak to the user's needs directly.
Boomers	Saving for retirement.	Face-to-face or over the phone will only use digital channels if required to face-to-face interactions.	Individual treatment that acknowledges their independence.
Gen X	Saving for retirement.	Will use all available channels: face-to-face, mobile, and online.	Overall customer experience.
Gen Y *Millennials*	Managing debt.	Mobile and online; prefer chatting/texting to in-person or phone conversations.	Speaking directly to their values and non-banking consumer interests.
Gen Z	Saving more.	Self-research directed online and will choose the appropriate channel, although prefer online communication to in-person.	Personalized experiences, backed by anecdotes and peer referrals.

Different banking needs for different age groups[9]

Survival for banks in the 2020s will look unlike anything banks have ever seen. Since Open Banking has removed the walls protecting them from disruptive competitions, banks must embrace tech to survive, and more favorably for them to thrive. Indeed, failure to leverage Open Banking to their advantage is not only backward-looking but could also prove fatal.

While there are many technical aspects that financial institutions can focus on to become more productive, like streamlining internal systems or automating more of the back office, we believe that customer-facing tech offers the best tools for survival.

9. Managing the CX Demands of 5 Generations (ABA Banking Journal)
How Age Impacts Consumer Behavior in Retail Banking (The Financial Brand)
Don't Alienate Boomers While Obsessing Over Millennials (The Financial Brand)
Millennials and the Traditional Banking Industry (The Goodlife Consulting)

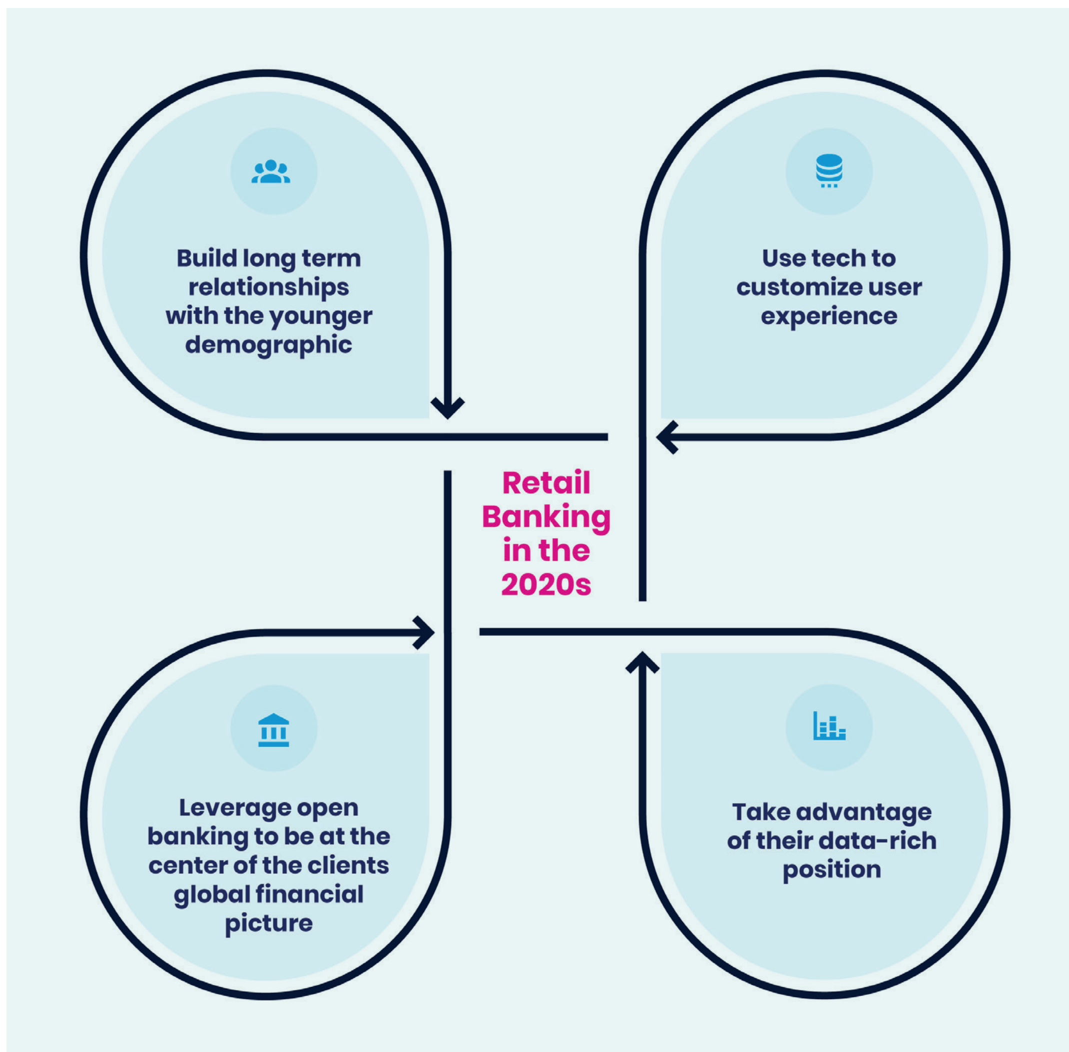
Part 3

How can retail banking survive *(and thrive)* in the 2020s?

Building long term relationships with the younger demographic

Generation Z and Millennials represent the largest combined demographic in the world. These people, 39 and under, will require banking services for decades to come. By fostering relationships with them now, a financial institution can maintain and grow its client and deposit base.

As older generations begin to draw down their balances in retirement and become a smaller demographic statistically, filling this gap is crucial. Further, these younger generations will have evolving needs from mortgages, to joint deposit accounts with life partners, to children's educations to fund. All of these are products that banks traditionally sell or finance.



Creating enduring relationships will require banks to meet each current user's expectations. Since consumers under 40 years old overwhelmingly prefer digital communication, banks must embrace Open Banking to build meaningful, personalized relationships with Gen Z and Millennials.

Relationships with these generations must be built differently than before. Both of these groups prefer online interactions to in-person ones and prefer to solve problems themselves. [10]

Only when they cannot either solve the problem themselves or must be physically present -- say to sign a mortgage contract -- will a Millennial or Gen Z'er go to a bank branch in person. Therefore, banks must ensure that their digital platform has ample resources for self-troubleshooting. Likewise, financial institutions should design their branch experience around providing meaningful interactions to show the human value of their business.

Additionally, Millennials and Generation Z highly value transparency.[11] Retail banks are notorious for piling on dubious fees, then concealing or contorting their justification. Millennials will not hesitate to call banks out on this practice, demanding justification or even 'voting with their wallets' by changing providers. For financial institutions wanting to maintain long-term relationships with this demographic, opaqueness and perceived dishonesty will run counter to that goal.

Use tech to customize the user experience

Building meaningful relationships with (potential) clients requires making each user feel important to the bank in question. Millennials and Generation Z overwhelmingly prefer to do their banking online. Since this communication starts with tech, banks must leverage tech to customize those interactions.

Banks can learn about each user's financial behaviors by analyzing their data. From there, the bank can predict services and products that speak directly to the user, all in an interface that makes banking more intuitive and personal. Banks can also use AI to help make chatbot interaction more human, pulling insights from each customer in real-time. Financial institutions that can speak to users on a more personalized level will be the ones who thrive going forward, selling more targeted products in the process. [12]

Millennials and Gen Z aren't the only generations to benefit from a customized tech experience. Many older consumers prefer to do their banking in a branch rather than online or on an app. And banks can use tech to enhance the in-person user experience for face-to-face interactions.

10. How Age Impacts Consumer Behavior in Retail Banking (The Financial Brand)
11. Millennials and Money: How Banks Are Missing the Mark (Forbes)
12. Retail Banking Distribution 2025: Up Close and Personal (Boston Consulting Group)

Using the same algorithms to build automated experiences for younger generations, banks can also learn about their older clients' needs and behaviors. Then, instead of providing these insights directly to the client via an app, it passes to the account manager via a CRM.

The representative can take these insights into account when preparing for an in-person meeting. The account manager will be able to provide tailored financial advice, resulting in a more meaningful in-person experience for the client with more significant deposits and complex needs.

Enhancing the user experience isn't limited to advice and information. Banks should also look at streamlining payments and making onboarding more enjoyable. What's clear is that getting the experience right is critical for success in the 2020s. Consultancy McKinsey discovered that the leaders in customer experience showed the highest increase in deposits.[13] When put together, tech offers banks an excellent opportunity to enhance the user experience across varying demographics and processes.

Taking advantage of their data-rich position

Banks have a distinct advantage over their fintech competitors: mounds of user financial data is at their fingertips. Since they collect information from clients at each transaction, a bank can, in turn, learn exclusive insights about their users.

While Open Banking compels financial institutions to share user financial data with third parties, banks have 'first mover' advantage. After all, the bank has all of its users' data stored on their servers. This data is in a format they understand, with little standing in the way between it and their data scientists. According to PWC, the number one priority for banks going into 2020 is enhancing customer data collection. [14]

This data allows them to learn about their customers on a more intimate level. With this information, the bank can then perform two critical tasks. Firstly, it can shape user experiences and journeys in a way more aligned to each client's tastes. This task is vital for building meaningful relationships with new and young clients.

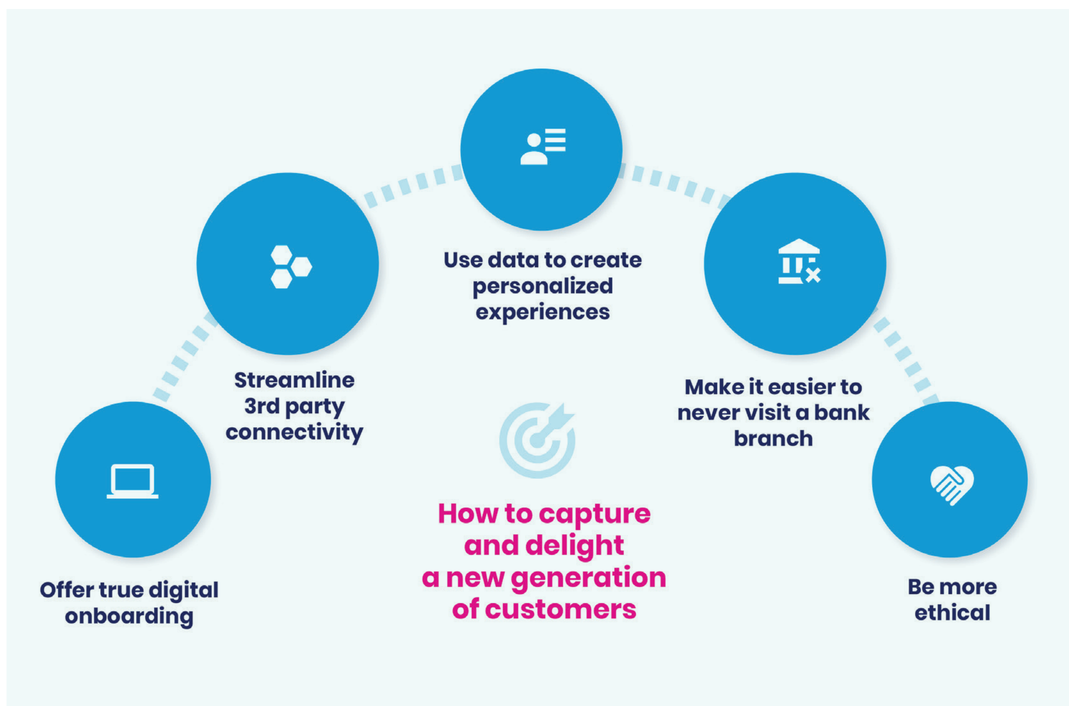
Secondly, banks can use the data to sell customized products to each client. Perhaps the bank sees that a client collects guitars through purchases on a website dedicated to that hobby. Why not offer her insurance for her collectibles? Another client does the majority of his shopping at organic and bio grocery stores. Maybe he would be interested in placing some of his savings into an ESG investment fund? Together, this data advantage will allow product and marketing departments to package and sell financial products with revenue-generating commissions that have less friction and lower costs.

13. Rewriting the rules: Succeeding in the new retail banking landscape (McKinsey)
14. Retail Banking 2020: Evolution or Revolution? (PWC)

Finally, banks can use the data to audit and improve internal processes.[15] With the right data scientists, a financial institution can look for inefficiencies in workflows. By perhaps tweaking only a minor process, the bank could potentially save millions.

Thankfully for banks, enhancing and collecting data is getting easier. Consumers of different buyer personas are all willing to share their financial data with banks. However, there is one caveat: that data must be used to provide more personalized experiences. [16]Banks should also be keenly aware of the regulatory risks and limitations involved with managing and collecting data. Open Banking in general and regulations such as PSD2 and GDPR should help guide these firms in maintaining their balancing act. [17]

User financial data is potentially a bank's most lucrative untapped resource. Banks that want to still be relevant by 2030 must be using their data edge to their benefit.



Leverage Open Banking to be at the center of the client's global financial picture

The spirit of Open Banking mandates that financial institutions must share their users' data with third parties. On the surface, this looks like bad news for banks who must let their clients' data flow to competitors. However, Open Banking also offers these legacy firms an opportunity to enhance their services.

15. Today's retail banking challenges and dynamics call for modern business models, innovation (Capgemini)
16. 2019 Global Financial Services Consumer Study (Accenture)
17. Ten years on from the crisis: Financial Markets Regulatory Outlook 2019 (Deloitte)

In addition to sharing their users' data, banks can also ask their clients to share their external financial data with them. In turn, the bank can adopt a fintech approach to their overall UX, aggregating their clients' different bank accounts onto their apps and web interface.

The effects of doing so are two-fold. Firstly, they can use the data to gather a more accurate financial picture of their client. The ensuing transparency allows the bank to market more customized products to the user that wouldn't be possible by utilizing internal data only.

Secondly, aggregating global financial data such as loans, credit, and balances held in other institutions, then making suggestions on it to enrich the user experience, keeps clients engaged.

Combined, banks can use Open Banking to remain at the center of their client's financial ecosystem. [18]When the bank sits at the center, their value becomes apparent to their clients. In an era when consumers are more frequently inclined to change financial services providers, keeping existing customers loyal and engaged will be essential for any bank's survival in the 2020s.

18. 2019 Global Financial Services Consumer Study (Accenture)

Part 4

In 10 years, what will banking look like?

Banking 10 years from now will potentially look radically different than it does today. The Open Banking movement will continue to evolve, and regulators the world over will bring clarity to the rules governing it. Another financial crisis could roil markets. The 2020s could be the era of negative interest rates, further upending the lending business.

Banking as a service could become the new norm, where customers build their 'plug and play' bank through a variety of different providers. New companies who merely provide a building template will let customers pick and choose which financial services and products they need. From there, the user will have a completely bespoke experience, allowing them to bank as they choose.

Dynamic financial marketplaces could dominate not only the initiation phase of lending but also create real-time refinancing opportunities. For example, a mortgage holder could go onto a platform and refinance their loan in near real-time as the underlying interest rates change. For lenders, this rate swapping could open up the door to more effective lending and financing operations. As the 'gig economy' becomes more prevalent, borrowers could adjust their loans based on their fluctuating monthly income.

Tech giants, if they still exist in the form as they are today, could all have retail banking licenses, issuing bank accounts and taking deposits. These firms would have spent the 2020s not only building banking infrastructure in-house but would have also developed or acquired other complementary services. For example, AI will continue to become more powerful. Very humanistic chatbots could read through a user's Gmail and Google Wallet history while helping a client reconcile their accounts.

The retail banking model will also have changed. Millennials and Generation Z will firmly be the most dominant demographic in ten years. Neither of these groups particularly sees the value in going to a bank branch for services.

Banks have already anticipated this shift by restyling some of their branches as 'coffee shops.' We could see virtual or remote account representatives replace branch managers. Video conferencing for discussions about financial planning could become the norm, with customers signing documents biometrically using an app or a to-be-invented device. All told, the challenges for banks in the 2030s will most likely be the result of new pain points arising in the 2020s.

Conclusion

Entering into the 2020s, banks are in a precarious position. The convergence of giant leaps in tech, the fallout from the most massive financial crisis in decades, and the advent of Open Banking have all reshaped the way consumers approach financial services. Additionally, massive demographic changes are redefining relationship dynamics as well as service level expectations.

Data continues to be the main driving factor in the world. As we find more ways to quantify more aspects of our lives, the insights gained, and the resulting innovations will only become starker.

Retail banking is not excused from this transformation. After all, no other industry is both under the regulatory microscope and simultaneously facing continuous pressure from tech startups. The Open Banking movement and the regulations underpinning it will only add to this pressure. Further, the opportunities presented by being a financial data collector are far too valuable to ignore.

For banks wanting to survive the upcoming decade, they must face these matters head-on. The financial institutions that will endure into the 2030s will be the ones that not only master their data but also build meaningful relationships, by putting them at the center of their customers' financial ecosystem.

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Where we've come from and where we're going