The Economist INTELLIGENCE UNIT

A whole new world:

how technology is driving the evolution of intelligent banking

Globally, retail banking has changed considerably over the past decade. Banks have adapted to changing consumer demands and expectations, new technologies, (eg, AI, blockchain), new competitors (eg, neo banks, payment players and tech giants), and new regulations like open banking (PSD2), while reducing costs and creating value. These combined factors have resulted in retail banks adjusting their business models to incorporate new technologies, rethinking their innovation strategies and investment focus, and altering their product offerings and how they are delivered.

In January-March 2019 The Economist Intelligence Unit, on behalf of Temenos, surveyed 405 global retail banking executives on the changes taking place in their industry to 2020 and 2025, their organisational response, and the longer-term impact on their strategy. This sixth iteration of the retail banking survey focuses on how these retail banks are incorporating and advancing technology delivery for their current and future customers.

The survey is part of a global research programme on retail banking, which includes in-depth interviews with retail banks, fintechs and regulators from five regions: North America, Europe, Africa and the Middle East, Asia-Pacific, and Latin America. The survey research and the interviews will be featured in a series of reports throughout 2019.

These are the key findings:

Strategic priorities are changing with the shorter-term focus being on product agility while preparing for the longer-term impact of open banking on the industry. For 32% of survey respondents, improving product agility is the top strategic priority up to 2020, followed by mastering digital marketing and engagement at 31%. However, by 2025 banks anticipate being much more focused on launching their open banking strategy (30%) and digital engagement

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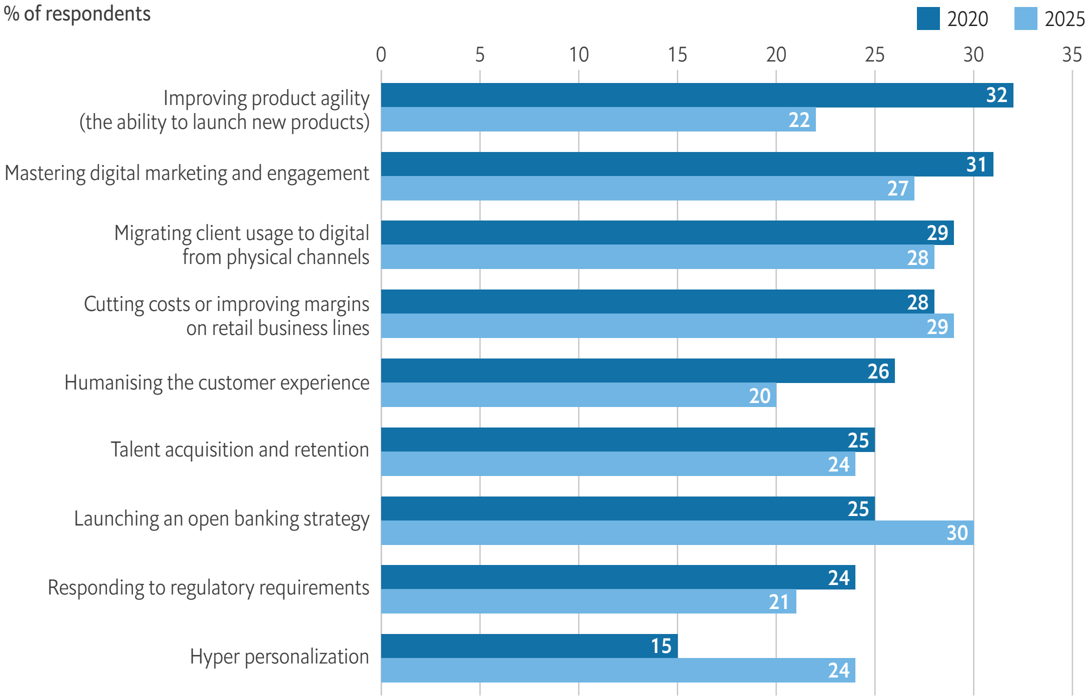
Chart 1: Strategic priorities
% of respondents

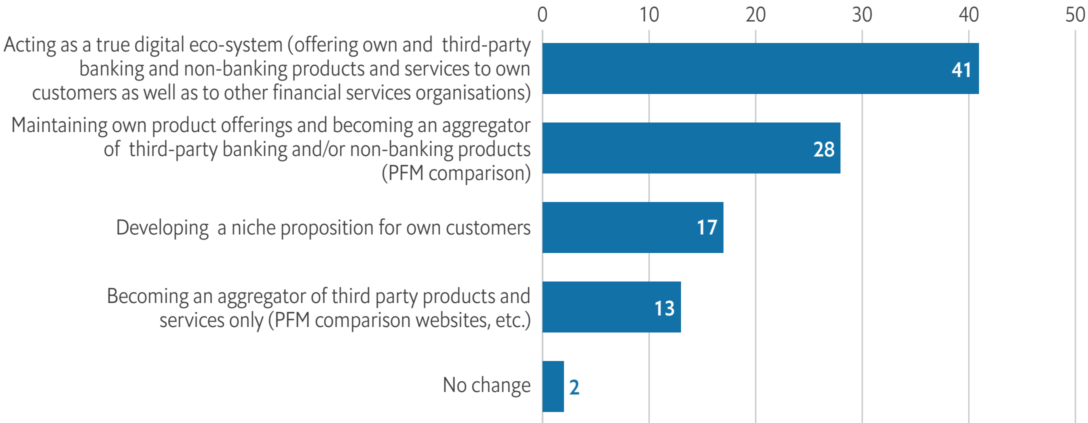


Source: The Economist Intelligence Unit.

(27%) than on product agility. This, at least in part, reflects the growing global impact of open banking, which is also reflected in how business models are evolving.

Banks are realising the true opportunities of open banking and adjusting their digital business models accordingly. In 2018 respondents were primarily focused on developing niche propositions for their own customers (cited by 61% globally). However, in 2019 they are now pursuing more proactive open banking strategies–41% see their business model evolving towards acting as a true digital ecosystem. A further 28% expect to maintain their own product offerings and become an aggregator of third-party banking and/or non-banking products. Only 17% are looking to develop niche propositions. This change may reflect a shift in organisational mindset when it comes to open banking; whereas a lack of C-suite understanding was previously the biggest barrier in relation to open banking, it is now the least likely factor to concern respondents. This shift may also reflect the greater regulatory scrutiny of open banking. New legislation to set standards for open banking in Europe, Asia and beyond are under consideration. The industry appears to recognise that a top-down strategy for developing common standards and security standards are key to widespread adoption by banks, fintechs and—most importantly—retail and small and medium-sized enterprises.

Chart 2: Digital business model evolution
% of respondents



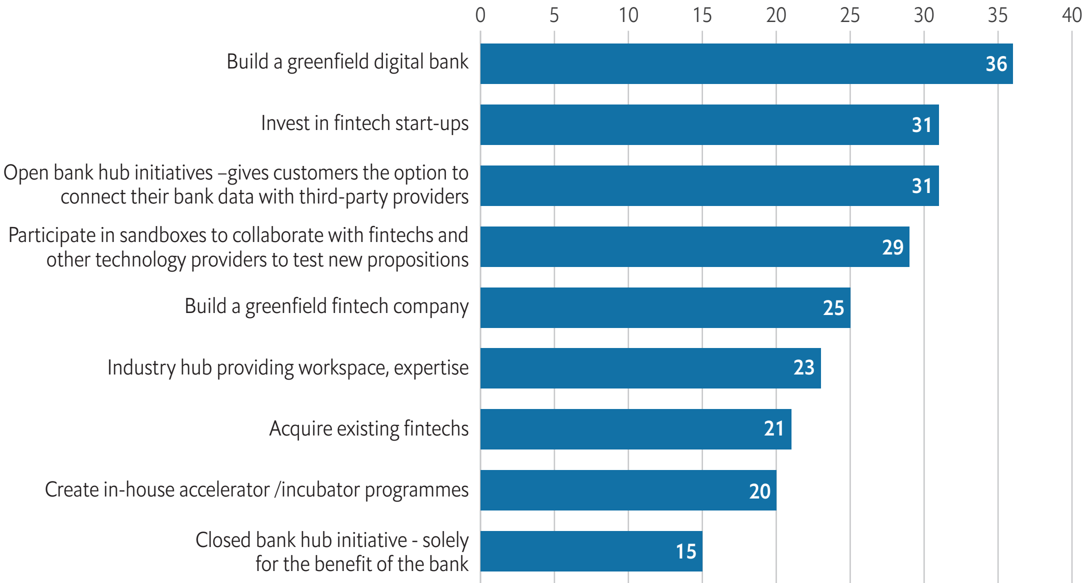
Source: The Economist Intelligence Unit.

As banks move into an open banking environment, delivering the right products to customers will require banks to be able to address customer concerns around data. Banks' main concerns around open banking relate to educating customers about data security (28%) while being able to capture their data (26%).

Banks are now looking to take on the challenge of creating an ecosystem and remain vigilant to existential threats from tech giants. Payment players are still viewed as primary competition into 2020 (cited by 39%). However, technology and e-commerce disruptors like Google and Alibaba are of concern to 29% of respondents now, with these tech giants still being seen as competition into 2025 (cited by 26%). And despite the difficulties in obtaining banking licences and the additional reputational risks such activity would bring, big tech are still testing the waters. However, because banking regulation remains fragmented and inconsistent from market to market, retail banks have to think differently both about how they innovate and who their competitors are. This may explain why 22% of respondents said they were concerned by competition from partnerships between technology giants and fintechs by 2020, rising to 26% in 2025. They are therefore thinking differently about how they innovate.

Retail banks' top new proposition for innovation is building their own greenfield digital banks. They continue to want to partner with fintechs, and also wish to be directly involved in testing new propositions. Although banks' innovation strategies remain focused on digitisation, open banking and growing their partnerships with fintechs in the retail banking sector, they are also looking to build from scratch. The top innovation strategy this year is focused on building greenfield digital banks—36% of respondents are deploying this approach. Open bank hub initiatives remain important (31%), while closed bank hub initiatives have gone from being the

Chart 3: What is your bank's innovation strategy?
% of respondents

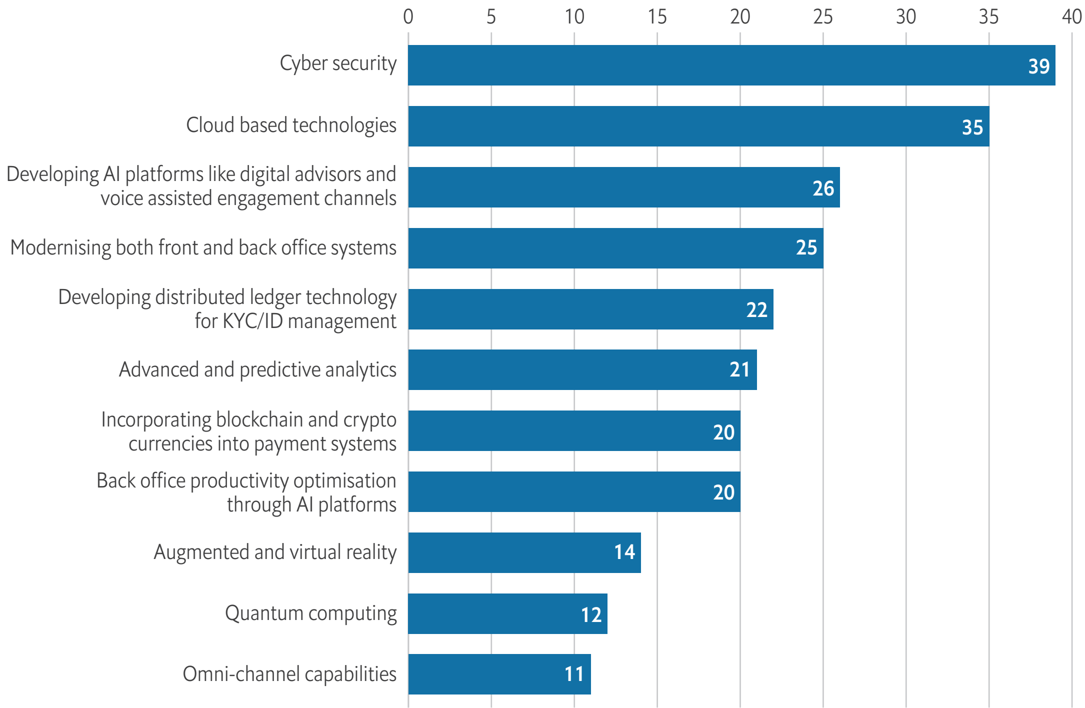


Source: The Economist Intelligence Unit.

key focus in 2018 to the least important in 2019 as open application programming interface (API) protocols have to work for all regulated or authorised third parties. Unsurprisingly, investment in fintechs remains a popular choice, with 31% of respondents citing this as part of their innovation strategy. Banks are also becoming interested in the security provided by new and existing regulatory sandboxes, as 29% are looking to participate in sandboxes to collaborate with fintechs and other technology providers to test new propositions. Over half of respondents (56%) believe that fintech-bank collaboration in sandboxes will become mainstream by 2025.

Respondents now believe new technologies like AI, machine learning and blockchain will have the biggest impact on retail banks in the short-term (36%) and even more in the longer-term (42%). Changing customer behaviour and demands are still having an impact (31%), but less than in 2018 (58%). And although traditional regulation on capital remains a concern (28% in 2020 and 22% in 2025), emerging regulation on digital technology (data protection, digital taxation, etc) is coming to the forefront with 31% citing this as having the biggest impact in 2020 and 2025. And when it comes to individual technologies, respondents strongly feel that AI will create better value for customers (61%), with the most valuable use of AI being to improve the user experience through greater customer personalisation capabilities (20%).

Chart 4: Where is your company focussing its digital investment?
% of respondents



Source: The Economist Intelligence Unit.

Banks are understandably focusing their digital investment on cyber-security. They are also looking to the cloud to provide them with necessary computing power. Banks' digital investment is focused on cyber-security (39%) followed by cloud-based technologies (35%) and developing AI platforms like digital advisers and voice-assisted engagement channels (29%). The majority of respondents, 68%, believe that regulators will tighten cyber-security authentication protocols in response to at least one systemic bank failure by 2025.

And three in five respondents (60%) foresee banks deploying more computing power in the public cloud by 2025 than they currently deploy in all the private cloud data centres. However, some respondents are still concerned about the cloud ~~39~~% of respondents cite data security and storage requirements around cloud-based servers as the biggest concern for them, surpassing inconsistent global data protection requirements (29%), the most worrying factor in 2018.

However, technology may enable better protection; customer fraud detection related to anti-money laundering/Know Your Customer processes will be the most valuable use of AI for 14% of survey respondents.

The global survey reveals signs that are some significant differences between what the banks are thinking about in the short-term, to 2020 and what they are thinking about in the longer term, to 2025, as reflected in the actions they have taken or are likely to take in the near future. The reasons behind these differences by region, and their implications for investment strategy, will be explored in forthcoming reports on each of the five regions.