FINASTRA

MARKET COMMENTARY

Opening the Next Decade of Community Banking: A Look at 2020 and Beyond

Nearly twenty years ago, at the start of the new millennium, the internet was still in its infancy and the Y2K bug threatened to hold financial institutions hostage. Fast forward nearly 20 years and Y2K is a thing of the past, put to rest by a spirit of relentless innovation and transformation.

Mike Dionne
SVP and GM, North American Community Markets

Vincent Pugliese
SVP and GM of Solutions North American Community Markets

Internet capabilities continued to evolve as well, enabling a new means of commerce and accelerating the pace of technological advancements for years to come. Now, as we near the end of the second decade of the millennium and look toward 2020, the technology fervor continues, challenging banks and credit unions to evolve in an environment of changing economic indicators.

What does 2020 and the dawn of the next decade hold in store for community banks and credit unions, and where should they put their focus to achieve the greatest performance? We recently turned to Vincent Pugliese and Mike Dionne of Finastra, to weigh in on the most pressing trends of the upcoming year and to shed light on the priorities that community financial institutions should consider as they look to 2020 and beyond.

Vincent Pugliese is the senior vice president and general manager of U.S. retail and lending solutions at Finastra. He leads technology strategy for the company, devising technology to address the modern challenges that banking organizations face. Mike Dionne is the senior vice president and general manager of North American community markets. He brings more than 30 years of experience with community banks and credit unions to his role at Finastra where he is responsible for developing the company's go-to-market strategy.

Together, they are shedding light on the priorities that community financial institutions should consider as they look to 2020 and beyond.

Clouds Could Be Brewing on the Regulation Horizon

According to Mike Dionne, the regulatory environment has been more permissive in 2019 than at any other time since the passing of Dodd-Frank. "When you juxtapose 2019 to coming out of the financial crisis, which has taken us quite a while from a regulatory standpoint, 2019 was pretty light compared to expectations," said Dionne.

He is quick to point out, however, that 2019 was not devoid of regulatory concerns, as large SEC registrants prepared for the implementation of the Current expected Credit Loss standard (CECL) in 2020.

THE FUTURE OF FINANCE IS OPEN

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ONE IN THREE financial executives report cost of funds and core deposit growth as their top concern for the future.

CECL requires financial institutions to reserve funds against losses at the time a loan is originated and represents a significant regulatory hurdle.

"But by and large, the big requirements that came out of the financial crisis, we've moved beyond that wave," said Dionne.

Unfortunately, election years historically bring uncertainty to the regulatory environment, and 2020 promises more of the same. Just this year, the proposed merger of Suntrust and BB&T sparked a spate of controversy, underscoring the contrast in political viewpoints on the issue of regulation in banking.

While President Trump continues to express support for easing the regulatory environment, Elizabeth Warren, a leading democratic presidential frontrunner, opposed the BB&T-Suntrust merger and publicly expressed doubt concerning the Fed's past scrutiny of bank mergers. Bernie Sanders seems of like mind, vowing to uphold and strengthen Dodd-Frank if elected.

While the current outlook on regulation is quieter make deposits could actually lose money by the time they withdraw their funds.

"As crazy as it sounds, there is a real possibility that the same negative-rate environment could make its way to us," said Dionne. "And banks should be considering the implications of that."

Funding is now the primary concern for community bankers, outpacing regulation, according to the CSBS 2019 National Survey of Community Banks, with one third of surveyed executives labelling the cost of funds or core deposit growth as their top concern for the future. The survey also revealed that community institutions rely heavily on both transactional and non-transactional core deposits to balance liquidity and gain new loans.

"Considering the current low rate environment, inexpensive deposits are paramount to a financial institution's success," says Dionne. "And banks need to increase their digital footprint to attract and retain new customers or members, given increasing preferences for online and mobile interactions."

Automation and other digital tools serve to not only streamline the account opening process but can ease the cost of onboarding and managing depositors. Vincent Pugliese agrees and adds that financial institutions can gain traction by taking a broader approach to technology enablement in 2020 as well.

"A top priority for every financial institution right now, in terms of investment, is creating a holistic, seamless account acquisition strategy across all sides of the business to offer a more seamless experience for the end customer or member."

Catching up to the Quickening Pace of Innovation

One factor that could interrupt technology adoption by community financial institutions, is the quickening pace of innovation. As technology capabilities continue to proliferate at a rapid pace, it becomes increasingly difficult for community banks and credit unions to keep up with advancements, according to Pugliese.

Emerging technologies, such as artificial intelligence, machine learning and even big data capabilities seem beyond reach for many community institutions who are still addressing the need for core digital services, such as online and mobile banking. According to the CSBS 2019 National Survey of Community Banks, 34 percent of respondents do not offer online loan applications and have no plans to do so over the course of the next 12 months.

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SVP and GM

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Meanwhile, new Fintech competitors are offering faster, more integrated options, increasing the competition factor by making it easier for consumers to interact according to their preferences.

Pugliese encourages banks and credit unions to focus on catching up to technology trends. “Open banking is just around the corner, and financial institutions need to be ready to embrace it,” he said.

Both Dionne and Pugliese agree that for the near future, and certainly 2020, big data will prevail.

According to Dionne, it has always been relatively easy to approve financing for borrowers with top credit scores, but he is now seeing financial institutions finding and targeting unique market segments, because technology allows them to make better use of data.

“I had a customer who started working with the immigrant market,” said Dionne. “Through data analysis, he uncovered factors that helped him identify loan candidates and determine how to serve this typically underserved segment.”

Finastra realized this early on, combining the streamlined capabilities of application automation with big-data analytics to create Fusion Mortgagebot Data Insights. With Fusion Mortgagebot Data Insights, Finastra united the data from over 1,400 Financial Institutions to create detailed comparisons, allowing lenders to quickly shift strategies when necessary in order to improve their loan application conversion rates.

But data is only part of the equation when it comes to making faster and smarter lending decisions. According to Dionne, financial institutions should also look to automation in 2020, to reduce the number of manual interventions in favor of straight through processing (STP).

Straight-through processing automates many key steps in a process, removing the need for human intervention. The result is a cleaner and more efficient way of doing business.

Online lenders are already using automation in the end-to-end application process to speed approvals and reduce risk. According to a report issued by the New York Federal Reserve Board, Fintech lenders are processing loans in 20 percent less time with 25 percent lower default rates.

McKinsey views a not-so-distant future where machines perform from 10 to 25 percent of work across all bank functions. Dionne agrees and predicts strong outcomes for both commercial and retail banks who invest in STP in 2020.

Achieving the Strength of New Technologies

Community financial institutions operate at significantly smaller scale and with lower budgets than the big banks, so keeping up with new innovations could remain a challenging prospect in 2020 and beyond.

“What we see is an industry segment still trying to catch up to the expectations set by the big tech companies, such as Google and Amazon,” said Dionne. “Banks and credit unions have always had a short runway for implementing the technologies necessary to provide this type of experience, and that runway is only getting shorter.”

One reason for the rapid need for technological adoption, is the emergence of open banking. Open banking simplifies interactions between third-party applications and the financial institution by creating an interconnected web where all parties share data.

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>
> **Vincent Pugliese**
> SVP and GM

The power behind open banking rests with Application Programming Interfaces (APIs). APIs are a set of routines, protocols and tools that enable disparate systems and applications to communicate.

"It's easy to understand where open banking is taking the industry if you think about the Blackberry," said Dionne. "In the early 2000's, everyone had a Blackberry, and RIM, the parent company, had a huge development staff all creating applications. Soon, Apple came along, opened their platform to third-party developers instead of creating them in-house, and we see who the market leader is today."

Open banking uses the same premise of platform sharing, allowing financial institutions to expand their offerings through third-party development. While some big U.S. banks have started to implement APIs, it is largely beyond the capabilities of most small financial institutions.

"The cost associated with developing and implementing these ground-breaking innovations is likely to be prohibitive for the community financial institutions," said Pugliese. "But there are other ways for smaller banks and credit unions to keep pace with technology and remain competitive."

To facilitate technology enablement, financial institutions of all sizes are beginning to partner with Fintechs and leverage existing APIs. Finastra is leading the way in this respect and setting an example for banks and credit unions to follow with the advent of FusionFabric.cloud.

"Early on, we realized that we could do more and create products faster by partnering within the Fintech developer space," said Pugliese. "So, we invested in an open and collaborative platform where third-parties can produce innovative solutions to solve many of the market challenges financial institutions face today."

These new applications go hand-in-hand with Finastra's core technology stack, expanding the capabilities that the company can offer to financial institutions and their customers. According to Pugliese, community banks and credit unions can extend their technology budgets by taking a similar approach.

"The future for any organization is about partnering and gaining the advantages of ecosystems," he said. "We're seeing a growing number of smaller financial institutions, in particular, who are moving from on-premise software and systems to the cloud, and this is going to continue into 2020 and beyond."

Cloud systems provide community financial institutions with the technology assets they need to remain competitive, but with less of the cost and fewer challenges. With cloud solutions, banks and credit unions can adopt the latest technology without the need to develop or maintain systems and infrastructure. The costs of replacing outdated software or hardware are also reduced.

By working with cloud providers, banks and credit unions can head off another deterrent to technology innovation, that of acquiring technology talent.

"I've had conversations with financial institutions where they might be using a legacy type product, maybe even as old as a green screen product, and the new millennial or gen Z talent coming in the door doesn't know what to do with that," says Pugliese. "In these situations, the institution's available talent pool is significantly minimized."

On the other hand, cloud services are built on the latest technology, increasing the bank's odds of finding employees with the right skills to join their ranks.

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What Key Tech Trends Should Banks and Credit Unions Watch?

When asked which technological innovations banks and credit unions should expect to see more of in 2020, both Dionne and Pugliese agree. Beyond the near advent of an opening banking environment, it is AI and machine learning.

"AI and machine learning are going to improve the customer experience in so many ways," says Pugliese. "For example, by making it possible for customers or members to have money move automatically from a savings account to a checking account based on their spending habits."

Finastra has made significant investment in AI in 2019, leveraging the collaborative properties of FusionFabric.cloud (FFDC). As example, a partnership with Monotto, an automated savings platform called Robosave. Monotto's RoboSave helps account holders increase their individual financial stability by analyzing transaction history to determine how much money can be saved on a daily basis. The program then automatically transfers that money out of the user's checking account and into their savings.

Both Dionne and Pugliese agree that Fintech collaboration like this will play an increasing role in the future of banking, helping community banks and credit unions to build stronger and longer lasting relationships with their customers and members.

"Utilizing Fintech offerings, community financial institutions can produce a group of capabilities," says Dionne. "Allowing their customers and members to create the banking experience they want to have and to maximize their relationship with their financial services provider."

About Finastra

Finastra is building an open platform that accelerates collaboration and innovation in financial services, creating better experiences for people, businesses and communities. Supported by the broadest and deepest portfolio of financial services software, Finastra delivers this vitally important technology to financial institutions of all sizes across the globe, including 90 of the world's top100 banks. Our open architecture approach brings together a number of partners and innovators. Together we are leading the way in which applications are written, deployed and consumed in financial services to evolve with the changing needs of customers. Learn more at **finastra.com**

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