The Economist INTELLIGENCE UNIT

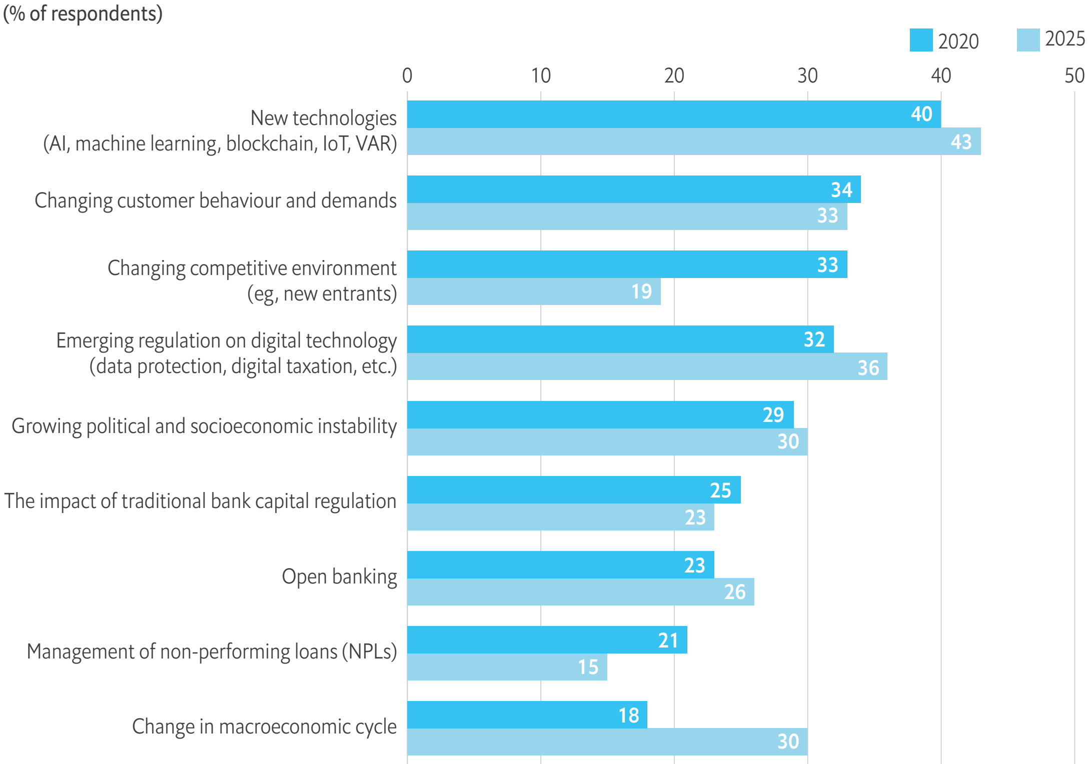
# A WHOLE NEW WORLD:

## How technology is driving the evolution of intelligent banking in North America

**New competitors pose an immediate threat to the North American banking order. Will banks be able to offer the level of customer experience needed to attract and retain clients?**

North American bankers sense danger more than most when new entrants join their market, according to a global retail banking survey conducted by the Economist Intelligence Unit. In anticipation of 2020, nearly a third of local respondents (33%) are feeling pressure from the changing competitive environment, compared to 28% globally. An even more pressing issue for North American bankers is keeping on top of changing customer behaviour and demands (cited by 34% for 2020 and 33% for 2025).

**Chart 1: Which trends do you believe will have the biggest impact on retail banks in your country by 2020 and by 2025?** Select up to three
(% of respondents)




Source: The Economist Intelligence Unit.

TEMENOS THE BANKING SOFTWARE COMPANY

As banking clients increasingly seek speed and convenience, and with Google the latest tech giant to announce plans for "smart" checking accounts[1] linked to the Google Pay app, new technologies are understandably seen as high impact trends on the sector for both the short- (40% for 2020) and medium-terms (43% for 2025).

In the long-term, emerging regulation of digital technology is viewed as a prime source of disruption for North American bankers (36% for 2025). Over a quarter (26% for 2025) cite open banking as a key trend.

## Lessons learnt

Challenger banks are also making their presence felt in North America, be they domestic start-ups such as Chime or Simple—now part of Banco Bilbao Vizcaya Argentaria (BBVA)—or overseas brands such as Monzo and Revolut which are now expanding their footprint. But as in Europe, a comparable developed market, banking customers are often hesitant to switch their primary banking relationship[2], even when a better deal is on offer.

However, the number of banks choosing to develop new greenfield initiatives has increased from 13% in 2018 to 29% in 2019, coming closer to the worldwide average (36%).

There are success stories, but also less fortunate examples when it comes to large banks creating new digital brands. JP Morgan Chase closed its fee-free mobile bank, Finn (which even offered limited access to physical branches), after reportedly attracting fewer than 50,000 customers[3].

Goldman Sachs has been more successful in attracting customers to its new savings brand, Marcus. The online savings and loan platform has no checking account and no app, and has attracted around 4m accounts and nearly US$50bn in deposits[4].

Despite advantages in data analytics and the freedom afforded by entering the market with a clean slate, it is worth nothing that big tech's move into banking may not always be a smooth experience. Apple has faced criticism for alleged gender bias for its new Apple Card[5], operated by Goldman Sachs.

[1] "Google Pay to offer checking accounts through City, Stamford Financial", *Reuters*, November 13th 2019. https://www.reuters.com/article/us-google-finance/google-pay-to-offer-checking-accounts-through-citi-stanford-federal-idUSKBN1XN1IQ
[2] "Our long, long, long relationships with banks: Are we missing out on better deals?", *Bankrate*, October 23rd 2017. https://www.bankrate.com/banking/best-banks-consumer-survey/
[3] "Americans Don't Want A 'Digital' Bank", *Forbes*, May 13th 2019. https://www.forbes.com/sites/ronshevlin/2019/05/13/americans-dont-want-a-digital-bank/#67f587ca3055
[4] "Goldman CEO: If Marcus were a Silicon Valley start-up, people would be 'throwing money at us'", *CNBC*, June 6th 2019. https://www.cnbc.com/2019/06/06/goldman-ceo-if-marcus-was-a-start-up-people-would-throw-money-at-us.html
[5] "Apple Card algorithm sparks gender bias allegations against Goldman Sachs", *Washington Post*, November 11th 2019. https://www.washingtonpost.com/business/2019/11/11/apple-card-algorithm-sparks-gender-bias-allegations-against-goldman-sachs/

## Customer demands

These events beg the question: what do American customers want? Finn did not offer the high rates that Marcus does, and its app may not have differentiated itself sufficiently from JP Morgan Chase 's own mobile offering. A 2018 S&P Global survey suggests fees are the key consideration for recent and potential switchers, with incentives and interest rates ranked ahead of the mobile app experience for those likely to move in the next 12 months[6].

But creating a better experience with lower overheads is hard when mobile platforms are built on old architecture, as Finn's was. Colin Walsh, founder and CEO of start-up Varo Money, hopes to avoid the same traps.

"A new build is much easier than a renovation," he says. "In terms of the technology, [corporate] cultures that are not in a growth mindset and a legacy of regulatory issues, it is impossible [for traditional banks] to focus on customers and innovation."

The innovation angle may explain why payment players are seen as a far greater and more immediate competitive challenge (cited by 41% of respondents for 2020), than the neo-banks (16%

### Nudging to save

Mobile banking firm Varo Money offers loans alongside checking and savings accounts. It hopes that its additional features will encourage more people to switch and save for their future.

"In the US, the state of financial health is so stark," says Colin Walsh, founder of Varo Money. "There are millions of people who struggle with their financial health, have no financial assets and are getting penalised by bank fees."

To encourage his customers to make full use of their accounts, fees are waived if they deposit their regular salary or freelance earnings, saving them hundreds of dollars per year, he says. Varo also offers an "early pay check" facility. If it knows when your regular salary typically arrives, it will make funds available two days earlier.

Varo has also embedded tools that nudge customers to save more.

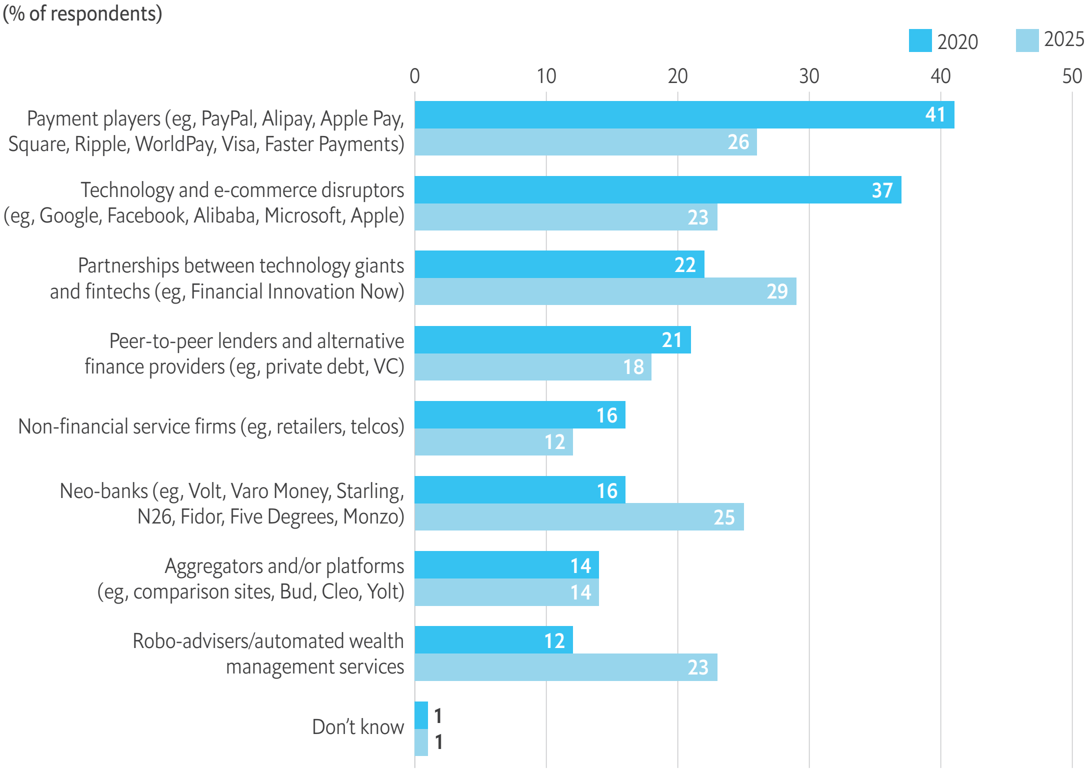
"One of the big reasons I started this company was to help consumers build financial resilience. You have to do that in a 'set it and forget it' way," says Mr Walsh.

Varo customers can elect to round up totals every time they use their payment card, with the excess swept into a savings account. They can also opt to have a percentage of their salary automatically transferred to that savings account, with 2.8% paid in interest.

"We're not trying to help rich people get richer; we're trying to help people build several hundred dollars of savings," says Mr Walsh.

[6] "US mobile banking survey respondents are averse to fees, open to other options", S&P Global Market Intelligence, June 29th 2018. https://www.spglobal.com/marketintelligence/en/news-insights/trending/8JqfpzPir2pda87sBaYolQ2

**Chart 2: Which non-traditional entrants to the retail banking industry will be your company's biggest competitor by 2020 and 2025?** Select up to two
(% of respondents)




Source: The Economist Intelligence Unit.

for 2020). Banks are also conscious of the upcoming threat posed by big tech firms teaming up with fintechs to create hybrids (cited by 29% for 2025) where the app provider has no need for a banking licence, and is not required to comply with regulatory capital ratios. Survey respondents also note the emergence of robo-advisers as an issue in the medium-term (23% for 2025).

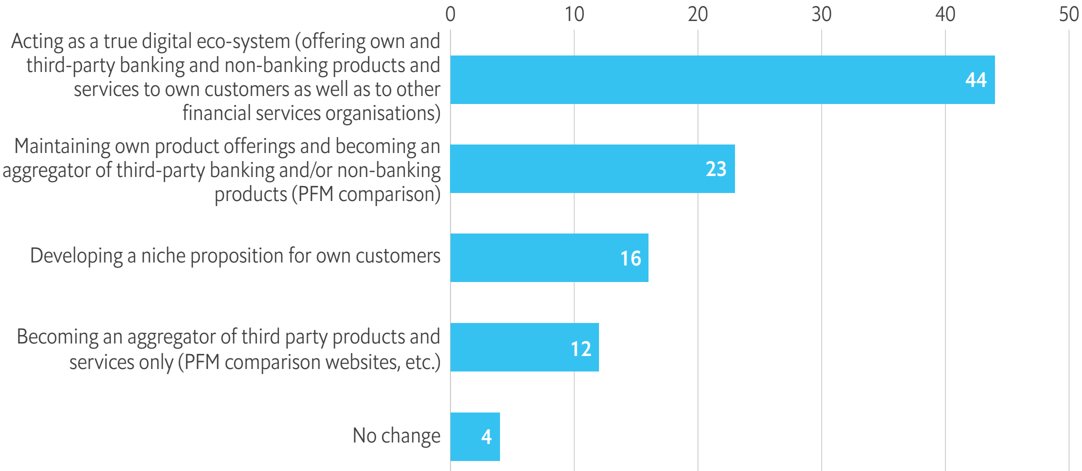
## Regulatory developments

Although tech firms may be more than capable of launching new services that fully replicate the banking experience, they appear to be holding back. North American respondents are the least likely to agree that sandbox collaboration between banks and fintechs will be mainstream by 2025 (48% vs 56% globally).

Federal regulation of fintechs, e-money providers and data has lagged behind much of the rest of the world, although Canada is ahead of the US in developing an open banking framework[7]. In fact, Canadian banks have launched initiatives to study opportunities around open banking and are

[7] Department of Finance Canada, January 11th 2019. https://www.fin.gc.ca/n19/19-002-eng.asp
[8] "Federal district court rules the OCC's fintech charter outside of the regulator's authority", *Business Insider*, October 24th 2019.https://www.businessinsider.com/office-of-comptroller-of-currency-fintech-charter-takes-hit-2019-10?r=US&IR=T

**Chart 3: What is the primary way in which you see your current digital business model evolving?** Select one
(% of respondents)




Source: The Economist Intelligence Unit.

starting to use application programme interfaces (APIs) in partnership with fintech firms to deliver new products.

As things stand in the US, it may simply be too difficult for tech giants to offer a consistent data-driven service with a relatively low regulatory burden across 50 states and 10 provinces until the rules are set. Federal agencies and state supervisors continue to argue, often in the courts, about who should have jurisdiction[8].

The primary focus for North American banks is to become far more agile (cited by 38% of respondents for 2020) and better-equipped to bring new features and products to market, but that is complicated when the rules of engagement have not been set.

Therefore it comes as no surprise that, when it comes to regulatory matters, North American bankers worry about a lack of international API standards (27%) and inconsistent data protection (27%). There are particular concerns about the regulatory risks of cloud-based services (41%). With a plurality of local respondents planning an open banking strategy (37% for 2025), the need for greater regulatory clarity will only become more pressing.

In the meantime, North American banks are focusing their attentions on becoming digital eco-systems which offer bank-related and non-financial services from third parties (44%). Only a few are attempting to build niche propositions (16%) or opting to become a third-party aggregator (12%). (see chart)

## Enhancing user experience

Digital investment in North America focuses on cyber security (45%), with significantly more respondents citing it than in Asia, Europe, the Middle East and North Africa. In line with the global average, almost seven in every ten (68%) survey respondents expect cyber-security rules to be tightened in the next five years following a systemic bank failure.

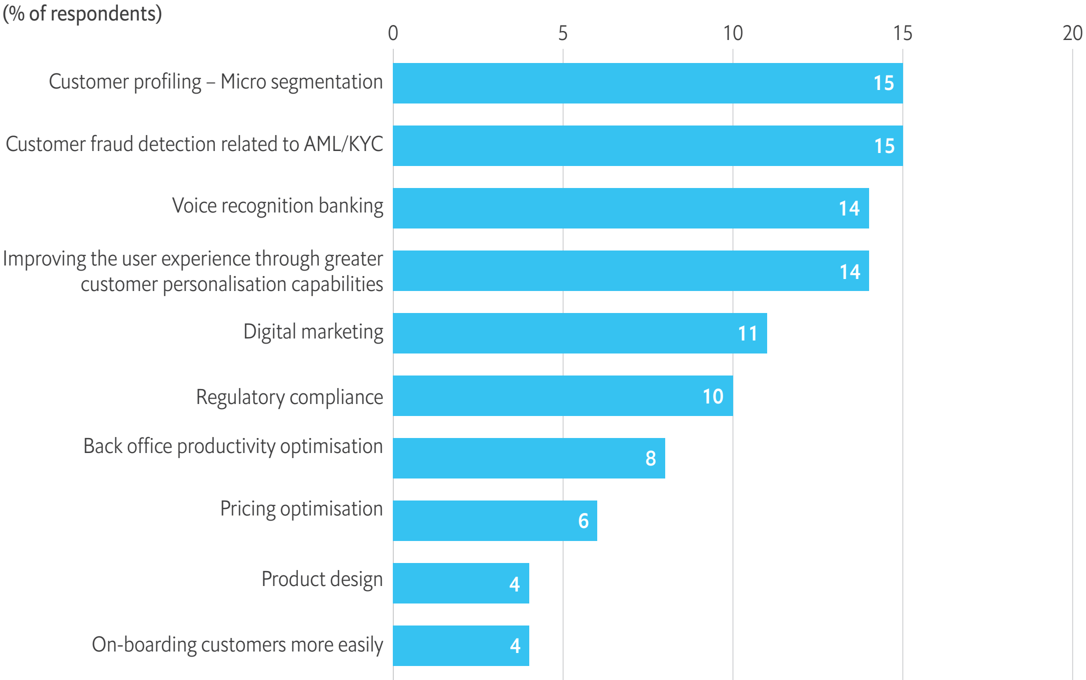
North American bankers are also investing in cloud-based technologies (36%) and artificial intelligence (AI) platforms (30%).

More specifically, North American banks are most interested in customer micro-segmentation (15%), hoping that AI will reveal new sell or up-sell opportunities. Deemed equally important, banks are seeking to boost their anti-money laundering and "know your customer" (AML/KYC) capacities when financial products are applied for or used (15%). Many also believe AI technology will help them enhance user experience by developing voice recognition features (14%) and greater customer personalisation (14%).

However, uncertainty about the security of personal financial information is cited by nearly half (45%) of North American bankers as their customers' top concern when it comes to the use of AI.

The Bank for International Settlements recently highlighted that data-driven big tech firms could be a force for good in terms of financial inclusion[9]. But it also underscores the downsides to a purely data-driven banking model, warning that there are "some signs that big techs' sophisticated algorithms used to process personal data could develop biases towards minorities".

**Chart 4: What do you believe will be the most valuable use of Artificial Intelligence for retail banks?**
Select one
(% of respondents)




Source: The Economist Intelligence Unit.

[9] "Big tech in finance: opportunities and risks", *BIS Annual Economic Report, Bank for International Settlements*, June 23rd 2019. https://www.bis.org/publ/arpdf/ar2019e3.htm

## Mutual benefits

For many banks, immigrants and refugees are not key target customers because their credentials and credit record data are incomplete. Vancouver City Savings Credit Union (Vancity) saw an early opportunity to try something different in the 1990s and has since opened over 12,000 accounts for people making a new life in Canada.

"You can't do much in our society without a bank account; you can't enrol your kids for school, you can't pay rent," says Tamara Vrooman, president and CEO of Vancity.

This poses a specific problem for refugees from the outset. They cannot open bank accounts without identity documents, but they may struggle to get ID without having a bank account, Ms Vrooman explains.

To overcome this problem, Vancity partners with settlement agencies at "first contact": if agencies can verify a person's ID, an account will be opened for them. Additionally, the bank's workforce covers 37 different languages. This enables Vancity to help customers gain recognition for their professional qualifications and to offer mentoring and financial advice services in immigration centres.

The alternative to such programmes is a growing issue, adds Ms Vrooman. Those who are not connected to the banking system early often fall into the arms of predatory payday lenders.

But even cooperative banks are not charities. There is a clear business case for meeting the financial needs of newcomers.

"The basic foundation of banking is trust. We earn that trust by helping them at the beginning and they reward us with their business, their kids' business and their friends' and families'," explains Ms Vrooman. "We absolutely make a profit—it's highly profitable in fact."