Rob Rubin, Eleni Digalaki, and David Morris

The Banking & Payments Show: Banking trends to watch for H2 2023

Audio

On today's episode, we talk about the top three banking trends for the second half of the year that are identified in Insider Intelligence's latest report, Banking Trends to Watch for H2 2023. We discuss in detail banks' renewed focus on customer acquisition, how mergers and acquisitions have returned to the space, and in what ways banks have begun rolling out generative AI tools. Join the discussion with host Rob Rubin and our analysts Eleni Digalaki and David Morris.

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Episode Transcript:

Rob Rubin:

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David Morris:

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Rob Rubin:

Hello, everyone, and welcome to the Banking and Payment Show, a Behind the Numbers Podcast from eMarketer. Today is July 25th. I'm Rob Rubin, GM of Financial Services and your host today. If you enjoy this podcast, please give us a five-star rating and subscribe. The title of today's episode is Banking Trends to Watch for H2 2023. I invited Eleni Digalaki and David Morris back to talk about the top three trends we're looking at for the remainder of 2023. Hi, guys. How are you doing?

David Morris:

Hey, Rob. Doing great. How are you?

Rob Rubin:

I'm great today. Eleni, how are you?

Eleni Digalaki:

I'm good as well. Thanks for having me.

Rob Rubin:

I'm always happy to have you. And before we get into it, you guys know it's coming and you don't know what it is, but let's get ready for some quickfire questions. David, what music artist do you first remember purchasing with your own money?

David Morris:

With my own money? It's funny, I like to keep some of the music that I listened to in my younger days under my hat, because it's a little strange and oblique. Thankfully, I can answer this question and avoid that and speak the truth. I think it was The Police.

Rob Rubin:

All right.

David Morris:

Yeah, it was when albums were a big thing, and I bought a couple of Police albums. And actually, I think I might have bought a Sammy Hagar album. I'm a little embarrassed about that.

Rob Rubin:

I don't know, I thought Sammy Hagar was good when he was in Van Halen.

David Morris:

Maybe. I think it was before that, but I was 13. You'll have to forgive me.

Rob Rubin:

Eleni?

Eleni Digalaki:

Oh, I was hoping I was going to get-

Rob Rubin:

I'm going to ask the same question. She was being so quiet. That's why I had to ask.

Eleni Digalaki:

I was hoping for a different question. Well, the answer is The Scorpions.

Rob Rubin:

All right.

David Morris:

The Scorpions.

Eleni Digalaki:

Yes.

Rob Rubin:

I could see it.

David Morris:

I think Sammy Hagar might have opened for them a few times.

Rob Rubin:

He opened for The Scorpions.

Well, this was a lot of fun, but we have a lot to cover, so let's get right into it. Today we're going to have a different format for the episode. I'm excited about it. Normally we cover headlines, then we look at specific statistics related to our topics, and then we dig deeper in the final segment. And today we're going to talk about the top three trends that we identified in our latest report. We're going to put a link to the report in the show notes for everybody.

So what we're going to do is just cover each of the top three trends one at a time and chat about them. And for our first trend today, there's a renewed focus on customer acquisition. Pick up their customer acquisition activities in this part of the year. And I wanted to talk about that, because I'm trying to understand, why are banks looking for new customers now and they weren't looking for them, say three months ago? David?

David Morris:

I would point to the recent volatility that I think everyone's aware of out there, Silicon Valley Bank being one component of this. I think it caused a lot of movement out there. A lot of wealthier investors-

Rob Rubin:

Got nervous.

David Morris:

... and Clients taking their money and trying to take it somewhere else. So money flying around out there and a decline, of course, in the deposit base.

Rob Rubin:

How are they trying to get to those customers? Are they offering specific kinds of incentives?

Eleni Digalaki:

I think, yeah, a lot of banks right now are offering signup bonuses that are pretty generous. [inaudible 00:04:00] one example; they each offer $400 to open a new checking account. Interest rates for deposits have increased, but not as much as they should have. But Q2 earnings, most banks acknowledging that there's pressure there and that they expect to continue increasing those deposit rates as well. So there's definitely some movement there in terms of offering more value.

Rob Rubin:

Okay. Are they looking to acquire just rich people, or are there other segments that are interesting?

David Morris:

There's probably a short term and a longterm play here really. The short term issue here is these wealthier investors, but the longterm play, an ideal opportunity now is Gen Z, because they're just starting to build those important banking relationships that banks would like to cultivate for the longterm. So I think they're definitely a great target.

Rob Rubin:

They should be. Two weeks ago we had this episode where I posited this idea; can a consumer go their whole lives without having any relationship with a traditional bank? And we were referring to Gen Z, or maybe the next generation after, Gen Alpha. But I think that banks are in a position where they don't offer the same kinds of seamless experiences that some of the Gen Z consumers are going to expect when they start to build relationships, and there could be fintechs that could compete for share of mind and then therefore share of wallet with these Gen Z consumers. So aside from higher rates and cash bonuses, what can a bank leverage to win a Gen Z consumer?

Eleni Digalaki:

That's a good question. Right now, a lot of people care about budgeting and PFM, especially with the current economic environment. Gen Z as well are very conscious of budgeting and managing their financing. I think that's one area, and maybe for many banks it's largely a marketing play. I don't know that there's a lot of innovation in this space.

Rob Rubin:

I think Chase has partnered with ... is it GreenLeaf? And that's focused on teen accounts. So in that way, they're trying to really get themselves into the teen's lives while they're still under their parents' wing.

Eleni Digalaki:

And I think another example of something that goes beyond a marketing campaign that focuses on budgeting is Truist's Long Game app. I think it launched a month ago, and it's an app that gamifies financial wellness.

Rob Rubin:

Oh, that's fun. Yeah, that's smart.

Eleni Digalaki:

Yeah. So you play Candy Crush-like games and win rewards and things. And that's definitely targeted to Gen Z, for example, and it's very timely as well in terms of focusing on what's top of mind for consumers right now.

Another thing when it comes to marketing is just where do you reach those Gen Zs? And we're seeing more campaigns on YouTube, TikTok and Instagram, which is where you would find them. Specifically when it comes for financial advice, influencers and topics like that as well. And then the last thing for Gen Z specifically is the digital experience. So you have them, you have their attention, they're considering you, but how do you close the deal? And you need to have seamless digital account opening experiences, because that's how Gen Z are acquiring your account.

Rob Rubin:

And David, we have you, I need to ask, because I've started to see an uptick of offers from credit card companies coming to me. Are credit card issuers also trying to get into the acquisition game?

David Morris:

I would say that that's been fairly consistent. They've historically been chasing new customers with rich acquisition bonuses. I think this could be a Gen Z play. You have the Apple Card, which has been just a juggernaut. And the irony is that it's such a powerfully attractive card, they don't normally offer anything, but they have introduced a very modest bonus recently for signing up. And I think that's an indication of the competitive environment, and that would ultimately be geared toward younger consumers.

Rob Rubin:

Well, this has been a really great start to our episode to talk about our trends, and we can see that there's a renewed focus on customer acquisition. And I think it's really for two different areas. There's a lot of customers in motion, because maybe they're a little nervous about their bank's liquidity, so banks are trying to grab those consumers as they can. I think there's a general need of banks, an ongoing need in the longterm for their health to acquire as many Gen Z consumers as they can. And something that we didn't really cover, but I think it's probably another issue, is the cost of funds and the need to have deposits on the books where they don't have to go out and borrow the money to lend money as much.

For trend two, we're going to talk about M and As. M and As are back. Banking M and A volume hit a six-year low last year, excluding 2020, and that was from Deloitte. It slumped further in the first half of 2023. There were just 19 bank deals in Q1, which was the lowest quarterly total since Q2 2020's nine deals. And that was from S and P Global Market Intelligence data. But we expect activity to pick up later this year. Eleni, why do we expect M and A activities going to be picking up?

Eleni Digalaki:

Yeah, I think the context you gave is very important because we're starting from a low base, so we don't expect tons of M and A. We just expect-

Rob Rubin:

More than we've had.

Eleni Digalaki:

Yeah, a reversal of that continued slumping in activity. But the reasons are manifold. One is the regulatory environment. There's still a lot of disagreement between regulators, and mixed signals in terms of whether they would scrutinize M and A more or favor it. But at the end of the day, we think that they would favor mergers that reduce systemic risk after the bank failures that we had at the beginning of the year.

The other thing that regulators have signaled is that they could soon ask banks with between 100 and 250 billion in assets to bulk up their capital reserves. So we think that's a segment where there could be some activity, because by merging and becoming larger, they can better absorb the cost of meeting those higher capital requirements.

And then the other thing is the valuations. So regional bank valuations have fallen by over 20%, year to date. That's seven times the drop of the sector overall. So obviously there are some attractive buys there for peers that remain strong.

And the last bit is the smaller banks, and this is more of a continuation of a trend. We've seen consolidation in that space for a while. But right now they're losing deposits at a faster rate than big banks, and they cannot afford to offer the monetary incentives that some other banks do. So it's more about, "How do I remain sustainable in that?" By looking for someone to save them.

Rob Rubin:

Because they can't really acquire customers very easily.

Eleni Digalaki:

Yeah. They can't acquire them with what's needed today to acquire them, the value that you need to offer, in a sustainable way.

Rob Rubin:

They also can't keep up in many ways with the technology experiences that new customers are expecting. So while you say, "Well, they can't acquire," it's because young consumers are looking for more seamless online experiences, and that's really hard for a small bank who tends to offer technology, but in my opinion, a lot of it is bolted together from third parties and it's not very great.

David Morris:

Yeah, I think you have a lot of difficulty, Rob. I know you're familiar with what Apple has done in consumer finance, and their consumer banking play that I think is coming to the fore now, that's something that even the biggest banks in the country I think should worry about, and just think about how much harder it is for these small banks to compete with that.

Rob Rubin:

Can I get you guys online? Which institutions are ripe for an acquisition?

Eleni Digalaki:

So I don't know if you're looking for names. I'll talk to you more-

Rob Rubin:

I love names. Can we name names?

Eleni Digalaki:

I'll talk to you in more general terms for a second. But I think banks that are looking to acquire, they'll be looking to acquire peers that can bring in key customer segments. And obviously from within those banks that have attractive valuations right now or they're struggling to operate sustainably in this environment, but they would be looking at the makeup of their customer.

Rob Rubin:

And the footprint. I think with these regional banks, that the acquiring bank is going to be looking at the market footprint. Does it expand their base where they operate, where they have a presence? The value of the brand that they're acquiring in addition to the customers that they're acquiring, the quality of the relationships that that bank has with those customers. So is there going to be a huge peel-off if they acquire the bank and customers are just going to leave? Other considerations that they look at is how well do their products fit? "If we acquire this customer, they're going to hate our products," is never a good one. But I think the other considerations are how many deposits are they acquiring in addition to the customers?

Eleni Digalaki:

Yeah, absolutely. We said how regional and mid-sized banks have struggled a bit more than bigger banks right now, but some of them remain very strong. They remain in quite a solid financial place. So they could be looking to acquire peers that have struggled a lot more.

Rob Rubin:

Oh, so they would be an acquirer?

Eleni Digalaki:

Yeah. Of a peer that's struggling more.

Rob Rubin:

But what's their endgame? They acquire more banks, they'll never be the biggest bank. Are they just trying to prop themselves up for a bigger acquisition? Do they need to go to the next level in order to really get absorbed by one of the really large banks?

David Morris:

See, I think it would be these mid-sized banks being able to build scale and better compete with the mega banks, and that the mega banks, I would hope there'd be some regulatory firepower that would disincentivize them from snapping them up. They're big enough. And that just goes back to Silicon Valley Bank and who's the winner in all of the volatility in the last six months. It's the biggest bank in the country. It doesn't need another acquisition.

Eleni Digalaki:

Yeah. And definitely Chase has gotten a lot of attention for the fact that it was allowed to become bigger. I think deals that fit into the 'too big to fail' narrative will be far more scrutinized.

Rob Rubin:

Like a bank like FirstBank acquiring smaller banks.

Eleni Digalaki:

Another regional player, yeah.

Rob Rubin:

Yeah. To just become larger. All right, I like that. Well, this was a great conversation about how M and As are back. And I always think that it's always going to be the big banks that eat up everybody, but here I think I've been convinced that some of the regional players are going to start acquiring smaller banks to become bigger regional players.

And for our third trend, guess what? Banks are going to begin rolling out generative AI. We've done a few episodes on gen AI and one thing that stands out is the risks that banks have using the technology directly with customers, and that's clear. So what are going to be the first use cases that banks are going to roll out?

Eleni Digalaki:

We've seen a big shift recently where banks are showing that they plan to accelerate adoption and more executives are saying they are implementing gen AI. So almost double the number who said the same back in February according to a Gartner survey. And also, the share of executives with no adoption plans has plunged from nearly 50% in February to just 7% today. So I think what's interesting is that banks have quickly realized that this is not just a hype, there's a great opportunity here. This tech is not going away and it's evolving very, very fast. And so what I think we'll start seeing in H2 is some of those early proof-of-concepts or pilots going into more of a full rollout.

Rob Rubin:

Right. What are some of the use cases that banks are going to roll out first?

Eleni Digalaki:

So yeah, I think you're spot on that it won't be consumer-facing applications. And I think that the three big areas will be marketing, assisting employees that face consumers rather than consumers directly, and product development teams, mostly within coding.

Rob Rubin:

What about fraud? I always think fraud protection would be a really good application, like to find fraud. David, do you know more about that because of payments?

David Morris:

I think from a payment perspective, there's certainly opportunity there, and I would imagine the same would go for banking. And when you think about payments, and I'm thinking about card issuers, that's ultimately a banking purview. So there's certainly opportunity to be able to implement it in that regard.

Rob Rubin:

I was going to talk a little bit about some of the early examples that we're seeing. You talked about marketing; is that the creating content kind of marketing?

Eleni Digalaki:

Yeah. Creating content or personalizing content or tailoring content so that you can target different consumer segments. And then it's other things like identifying new customer segments or generating alternatives for aid testing, things like that. There are a lot of applications within marketing.

Rob Rubin:

And those are all not really customer-facing, but the one that's most customer-facing would be the call center assistance.

Eleni Digalaki:

Mm-hmm.

Rob Rubin:

David, what types of guardrails will regulators have as it relates to gen AI?

David Morris:

I mean, this is actually, Rob, where I maybe take off my payments and banking hat and just put a macro view to this.

Rob Rubin:

Okay. That's great.

David Morris:

When you take a look at anything new, I think of crypto, that's the first thing I think of, anything new that just hits like a rocket and people don't know enough about it. They don't know how it's going to impact customers. They don't know how it's necessarily going to harm them or even harm the entities that are providing the service. Regulation takes a while to catch up, and that's one of the reasons you see just this cataclysm of volatility in crypto. And maybe that gets sussed out and you see a continuing positive trend with cryptocurrencies. I think that there are certainly lessons that were learned by regulators coming around and finally being able to take a look at how to regulate crypto.

Rob Rubin:

They'll apply those to gen AI?

David Morris:

I think they definitely should learn how quickly things can change and turn and the detriment that can accrue as a result of that when there is no regulatory oversight. And I think that there's definitely a very strong need for regulatory oversight of AI, particularly when you're thinking about banking because of how fundamentally important it is to the stability of our society and the trust we have in the financial system.

Rob Rubin:

Yeah. But it feels like the regulators don't really do something until something bad happens.

David Morris:

Right. I said 'hope' and I said 'should'. I don't think that actually is going to happen. It's going to be a few years down the line after something horrible might happen.

Rob Rubin:

Before something bad happens. Obviously something bad could happen. A lot bad could happen.

Eleni Digalaki:

Yeah. I think banks are also very cautious in their approaches, just because it's not just regulatory or legal repercussions of getting it wrong, it's also the brand ones. So far, I think the early examples that we've seen are not consumer-facing. Many banks are saying, "We know it's important, but we're doing it at a very slow pace." I have a feeling that banks themselves are also very cautious, and I also have the feeling that the regulator is trying to get ahead of this. I don't necessarily know that they will get ahead of this, but I'm hoping that they won't be as far behind as they often are with things.

David Morris:

I think that's a great point, Eleni. The conservativism of banks is what ultimately may help ensure that something unforeseen and negative doesn't happen. But I'm not sure we could say the same about the broader financial services industry, I guess.

Eleni Digalaki:

Yeah.

Rob Rubin:

Well, I think that that really sums up our trends. So our first trend really was about customer acquisition and that banks are going to start to pick up on customer acquisition. Our second trend was covering M and As and that we're going to see a pickup of M and As. And where we're going to see it is from regional banks buying smaller banks. And then our third trend is about gen AI and how banks are going to be cautious rolling out gen AI. They're not going to start rolling it out to face customers straight away. They're going to roll it out behind the scenes; marketing support, app use cases, customer service, backroom use cases. I think fraud detection use cases are also going to be one that they're going to start to look at very carefully. I want to thank Eleni and David. This was so much fun. Thanks for today, guys.

Eleni Digalaki:

Thank you, Rob. Thanks for having us. And nice to catch up, David.

David Morris:

Thanks very much.

Rob Rubin:

Yeah, this was so much fun. I want to thank everyone for listening to the Banking and Payment Show, an eMarketer podcast. Also thank you to our editor, Todd. In today's episode, we referenced our H2 2023 Banking Trends Report, and we have a link to that report in the show notes. Our next episode is on August 8th, and you'll not want to miss it. See you then. Bye, everyone.