BAI POWERING SMART DECISIONS.

BAI Banking Outlook Special Report

Top trends and challenges for 2024

INTRODUCTION

Growing deposits, attracting new customers and improving their digital experience are top goals for bankers in 2024

Traditionally staid and reliable, deposit accounts turned volatile in 2023. Their uncharacteristic movement is expected to continue through at least the first half of this year.

For the first time, deposit growth is the No. 1 business challenge in the year ahead, according to the annual BAI Banking Outlook. For this 2024 Trends report, BAI surveyed slightly over 100 financial services organization leaders.

To gauge consumer sentiment, BAI surveyed 1,000 consumers who were equally divided between all four generations. Consumer responses were collected twice in 2023—in March and again in September.

Inflation played the leading role in the flight of deposits. The high cost-of-living forced many consumers to spend down some of their checking and savings deposits to meet their expenses. In other cases, consumers drained or closed deposit accounts to seek financial products that produced higher yields or better returns—from CDs to stocks.

Competition for consumer deposits, driven by the Fed's aggressive interest rate hikes in 2023, compelled banking leaders to offer more competitive savings rates. The high rates were costly, but banks can't live without deposits—the lifeblood of their business models.

Attracting and retaining deposits supplanted acquiring new customers—the top business priority of bankers for the 2023 BAI Outlook. The customer digital experience fell from second to third for 2024. But

Deposit Growth is the top business challenge

	2023	2024
1	New customer acquisition	Deposit growth
2	Customer digital experience	New customer acquisition
3	Acquiring and retaining top talent	Customer digital experience

it remains a vital imperative as banks and credit unions continue their digital transformation in 2024.

Disappearing from the Top 3 for 2024 was talent. The intense war for talent of 2021-2022 eased in 2023 to the point where many banks trimmed their workforces.

But Todd Barnhart, PNC's executive vice president and head of retail distribution, says bankers should not lose sight of the need for talent. "We need to think about why somebody would want to come and work for a bank, whether it is in a branch or in a technologist's role," he says.

"Finding tellers, personal bankers or branch managers is still competitive. We need good people with the right personality who have digital and tech savviness and who can explain to customers how to get set up on the mobile app or to talk about Zelle. How do we as an industry position that message about pay differences and career opportunities?"

Barnhart says despite all the challenges for deposits, for customers and for talent, he's confident about the year ahead and is confident of a soft landing for the economy.

This Special Report, "BAI Banking Outlook: 2024 Trends," is designed to provide banking leaders with actionable insights to make smart decisions amid the challenges that lie ahead this year.

Deposits go from gathering dust to the golden ticket

Isio Nelson, BAI's managing director for research, once displayed a quote on his bulletin board that said: "Deposits used to be boring."

But that's far from the case today as bankers have identified deposit growth as their top priority for 2024. Rapidly rising interest rates in 2023 that prompted depositors to chase high-yield "hot money" coupled with others drawing down their checking or savings accounts in response to inflationary pressures took a toll. So did the fallout from the failure of Silicon Valley Bank that prompted some depositors to seek the relative safety of large banks.

The equation on deposits has changed dramatically in 2023. Suddenly, deposits are the golden ticket.

"There once was a point where banks were so inundated with deposits that they were almost turning them away or doing things to make them less attractive because they couldn't put them to work," Nelson says. "Deposit growth went from not even making our Top 10 in 2022 to being No. 1 for 2024. Now every bank CEO is asking: 'Where are we at with deposit gathering?'"

The conditions that drove deposit outflows in 2023 are expected to continue through at least the first half of 2024. "Checking decline will continue," Nelson says. "Increased spending, inflation and reallocation of low-yield deposits to higher-yield deposits will continue. But as we get to mid-year, conditions should begin to normalize. We will see deposits go from negative to positive."

Interest rates above 2-3% appear to send some depositors in search of higher-yielding alternatives, says John Rountree, BAI's head of client engagement.

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>
> ISIO NELSON, BAI

"In our experience, 2-3% seems to be the tipping point, particularly when inflation is where it is today" Rountree says. "When the consumer can get north of 2% on their money, it makes sense to go out and find that yield. When rates go up to 4 or 5%, people feel foolish for keeping money in a 0% checking account."

In the past year, he says, consumers have learned how to easily move their money around to chase rates, and they have become more comfortable with having more than one bank for their money. With the recent streamlining by most financial services organizations of online account openings, many savvy consumers have become more active rate shoppers.

What do depositors want? Across every generation, it's low fees followed by best rates. Members of the Gen Z and Millennial generations are attracted to a bank with values that align with their own, while members of the Gen X and Boomer+ generations cited such factors convenient branch networks and cash incentives/rewards as important considerations.

New customer acquisition will remain imperative in 2024

Growing deposits may be the consensus top priority among banking leaders for 2024. But at PNC at least, it's new customer acquisition, says Todd Barnhart, executive vice president and head of retail distribution.

Acquiring new customers—2023's top business challenge—slipped slightly to the second slot for 2024.

"We would flip No. 1 with No. 2," says Barnhart, who's also vice chair of BAI's board of directors. "Anybody can put a high rate out there and get deposits, but how sticky are those deposits?"

Acquiring new customers along with their core deposits—checking, savings and other deposit accounts—is what leads to a long-lasting relationship, rather than simply a one-off for a hot rate, says Barnhart who leads PNC's 2,300-unit branch network across 29 states and the District of Columbia. The bank has $557 billion in assets.

Mark Riddle, BAI's director and research intelligence expert, says becoming a customer's primary financial institution—or PFI—is invaluable.

"Being primary is important because when you are the primary financial services organization, you get a higher percentage of total customers deposit balances," Riddle says.

"You don't get all their business, but you start out getting 60%-plus of their deposit balances for most generational segments," he says. "Gen Z is less loyal in terms of share of deposits at the PFI. They spread their deposit business around more than others. But if you're their PFI, you still get 55 cents of every dollar of their deposits."

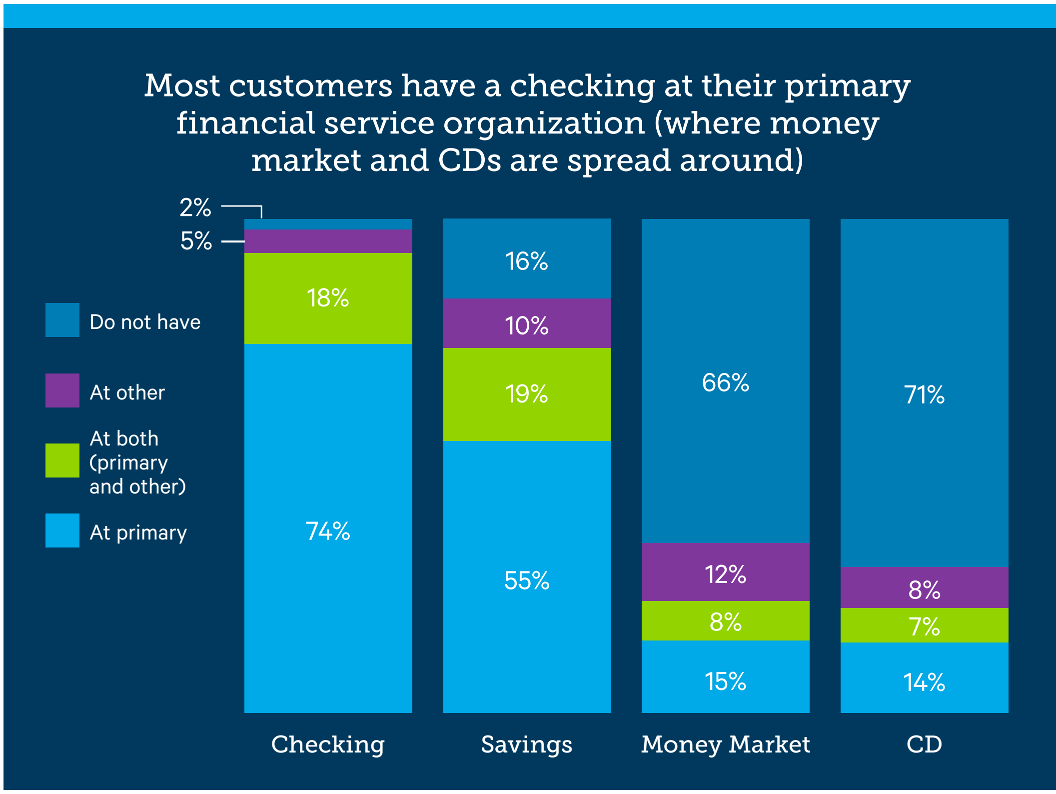
Barnhart says, "We might not get every dollar of a new customer's deposits because they might chase a high online rate being offered by someone, or they might park some of it in a CD. But at least we have some core deposits that are likely to stick with us for a while. We can count on that as opposed to the day-to-day machinations of hot deposits and chasing rates. That's why I think new customer growth is important."

Inducing customers to stick around "starts by treating customers well and valuing the relationship," Barnhart says. "You provide a great customer experience by making sure they have the tools they need. A branch interaction is important, a call center interaction is important, and a digital/mobile interaction is important."

He adds, "You must have competitive rates, but you don't always have to be top of market for core deposits. You just have to be fair."

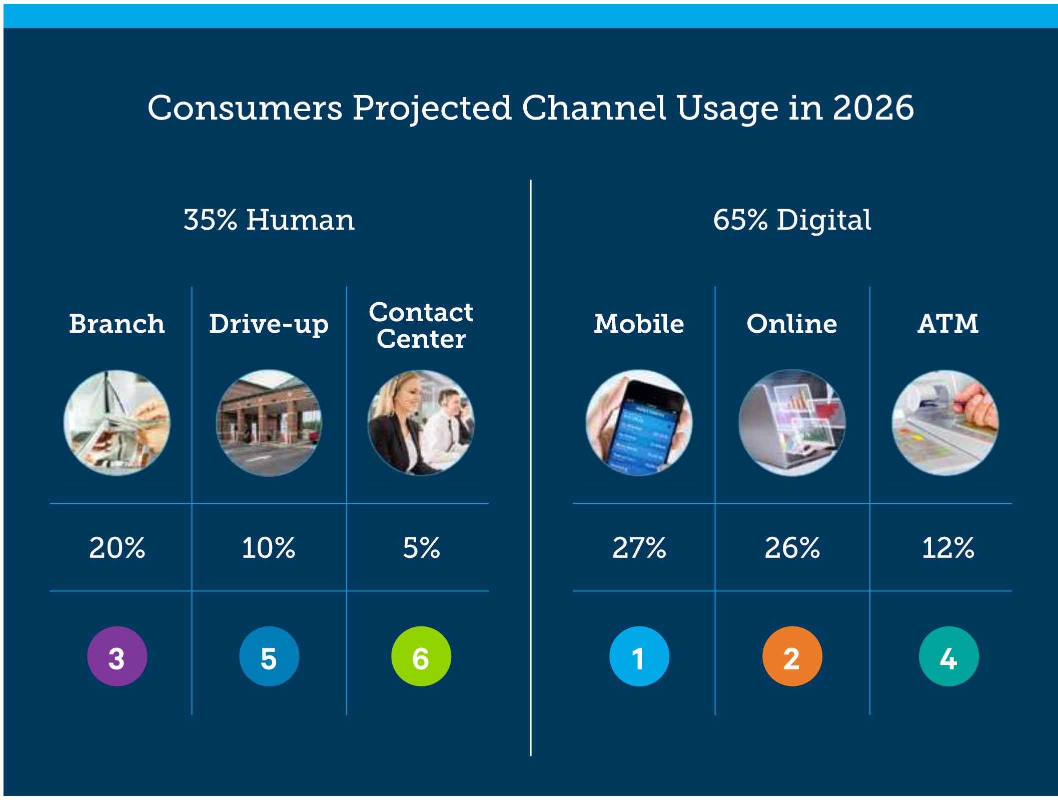
When consumers were asked their top reasons for selecting a PFI, they cited cash incentives/rewards as their third-highest preference, behind lowest fees and best rates.

Cash bonuses have become increasingly popular amid the current climate, says BAI's John Rountree. "For example, a bank may



offer a $250 cash bonus if the consumer opens a new checking account, establishes direct deposit and makes an initial minimum deposit to earn the cash incentive."

"While the new consumer gets the one-time cash incentive, the bank does not have to change its overall pricing strategy on the entire deposit portfolio. "You're effectively paying more on the new money without having to change pricing for existing customers by increasing interest rates," Rountree says.



Bankers continue to prioritize the customer digital experience

Although bankers have long prioritized the digital customer experience, it slipped to No. 3 on the list of top challenges for 2024. But banking leaders aren't taking their eye off the ball, according BAI's Mark Riddle.

"During the pandemic, the digital customer experience was even more important as financial services organizations cut hours or services in branches and had limited in-person interactions with customers," Riddle says. "After the pandemic, there is a little less pressure on the digital channel as branches have re-opened and returned to normal."

He adds that digital is still critical, especially going forward. Asked to project their omni-channel usage by 2026, consumers said they expect it to be 65% digital (mobile, online, ATM) and 35% human (branch, drive-up, contact center).

All of PNC's channels contribute to the customer digital experience, says Todd Barnhart. "They are all interrelated. We don't see them as exclusionary but complementary channels. For example, we make multichannel offers where the branch is a better place for fulfillment. And sometimes on the credit side, it's easier for the customers to visit the branch."

Adds Barnhart, "To be successful going forward, we need to humanize the digital side and digitize the human side. We bring those together, which is what the majority of our customer base wants — the hybrid model."

With the migration to digital, banks and credit unions must get the customer digital experience right. That's particularly important to Gen Z. Nearly six in 10 of them said they would switch financial services organizations in favor of a bank that offered a better app and other digital capabilities.

Fifty-three percent of Millennials said they would make the switch, while 34% of Generation X and 15% of Boomers+ said they would do the same.

All generations said the best way to improve the digital customer experience is by offering 24/7 customer service—an expensive proposition for banks. It could be that customers are frustrated by the online account opening process.

When consumers were asked why an application was started online but not completed in that channel, the leading response was that they filled out the information online but still had to finish paperwork or verify their identity in a branch.

The next leading response was: "I could not verify my identity online to open an account," followed by "There was a technical glitch," and finally "There were too many questions online, so I gave up."

As digital banking evolves, it must get easier to open and close accounts, receive advice on complex products and services and resolve problems consumers have.

Younger generations attracted to direct banks

The percent of consumers who said their primary financial institution is a direct or alternative bank grew slightly during 2023.

"The online-only or neo banks that offer a better value proposition than the traditional banks will continue to be attractive to new customers," says BAI's John Rountree. Features such as early access to paychecks or no fees on overdrafts catch the eye of consumers, especially the younger generations.

Direct banks have also been expanding their portfolios of checking and savings products to better compete with community, regional and large banks.

In the March consumer survey, 25% of Gen Z said a direct bank was their PFI. In September, the figure was 26%; for Millennials, it was 22% in March and 26% in September; for Gen X, it was 16% in March and 23%; and for Boomers+, it was 15% in March and 16% in September.

For all generations, it was still the large banks that commanded the largest percentage of PFIs. That ranged from 37% for Gen Z to 45% for both Millennials and Gen X.

When consumers were asked in September the type of institution they used for their most recent online loan, 65% said a direct bank versus 35% for a traditional bank.

Nearly three-quarters (73%) of consumers said they opened a new deposit account with a direct bank. Nearly two-thirds (65%) of consumers said they opened a new loan account with a direct bank.

Traditional banks are keenly aware of the competitive threat posed by the branchless upstarts. When bankers were asked: "To what extent do you feel competitive pressure from fintechs?" nearly half (48%) answered either "always" or "often." Only 13% answered "seldom."

When bankers were asked if fintechs can help banks and credit unions, 46% said they have learned lessons from the fintech community that they plan to implement in 2024. The same percentage said they plan to collaborate with fintechs this year.

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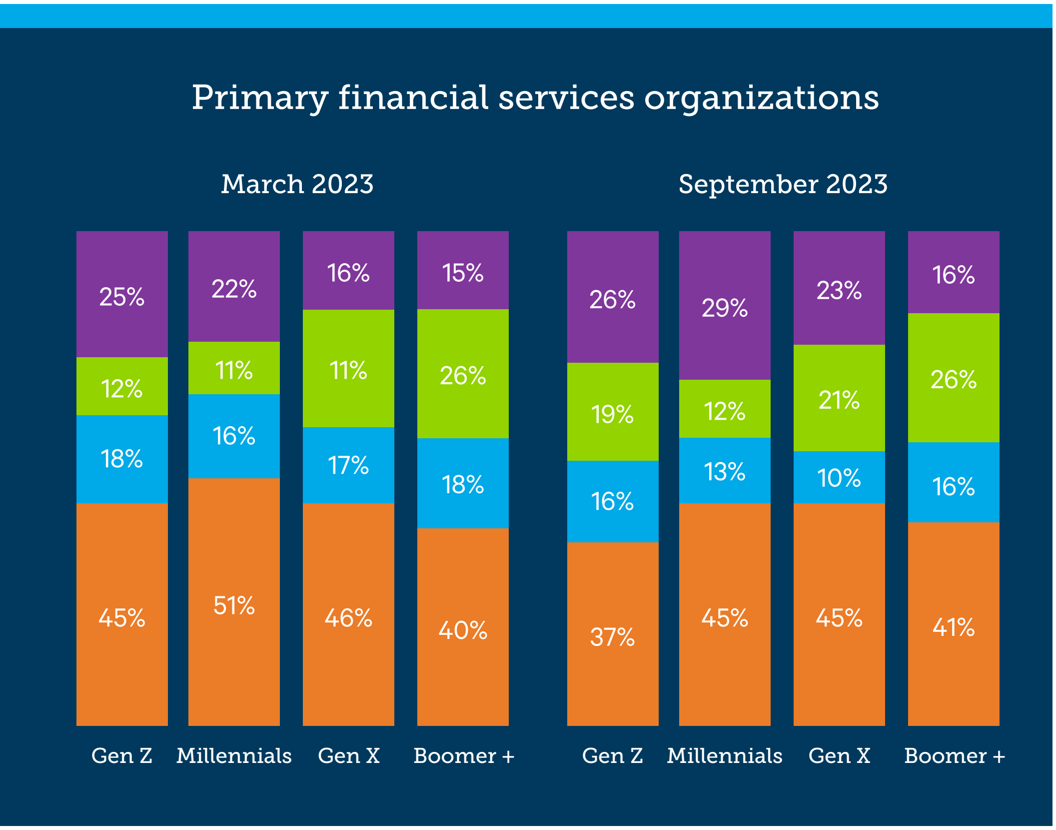
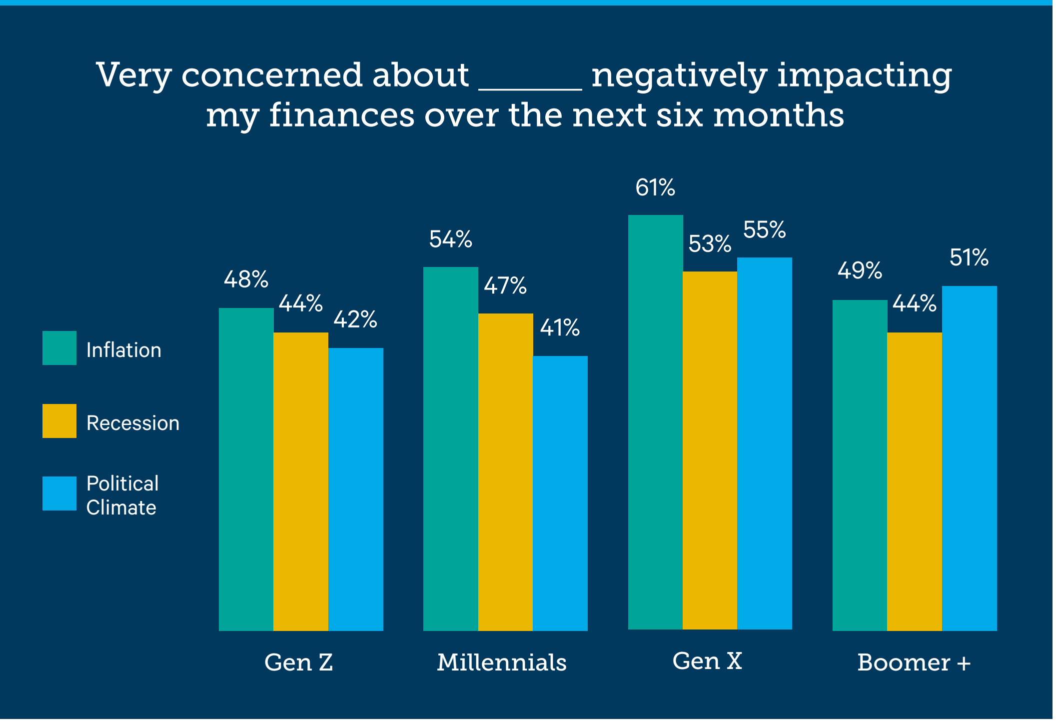


Consumers' optimism waned in 2023

2023 seems to have taken a toll on consumers' financial spirits. Sentiment across generations declined from the survey in March to the survey taken six months later.

BAI's Isio Nelson sees two elements weighing on the consumer psyche. "During the pandemic, the consumer built up a surplus



of funds," Nelson says. "They couldn't spend it, so they just kept the money in the bank."

But as the pandemic receded, people began spending again, and inflation began taking a bite out of their deposits, he says. "The consumer looks at their bank as if it's the bank's fault that they don't have as many deposits."

The other factor is the impact of the Silicon Valley Bank collapse. "Banks were perceived positively for their efforts during pandemic. But all that goodwill was almost wiped out overnight by the failure of SVB."

Asked in March if their financial situation will be better in six months, 49% of consumers said yes. When asked the same question six months later, that figure fell to 44%.

An even sharper six-month drop—from 40% to 28%—came in response to this question: "Will you have excess deposits to invest in six months?"

Gen Z, Millennials and Gen X cited inflation as the issue that will most negatively impact their finances over the next six months. Forty-eight percent of Gen Z said inflation was the leading culprit; 54% of Millennials cited inflation; and 61% of Gen X pointed to inflation as the factor posing the greatest threat to their finances.

The Boomer+ generation pointed to the fractious political climate as the element that will most negatively affect their finances over the next six months. The political climate was cited by 51% of that generation, narrowly edging inflation, which was cited by 49% of them.

Technology integration is again pivotal in year ahead

Banking's digital transformation continues its forward march. As they did last year, banking leaders indicated their top investment priority for the next two years is technology integration and platforms.

The second-leading investment priority is the customer digital experience followed by fraud mitigation. The customer digital experience was No. 2 last year, but fraud mitigation is new.

BAI's Isio Nelson says some banks, in their quest to provide a more frictionless customer digital experience, risk leaving their apps and online systems vulnerable to attack by fraudsters. Enhanced cybersecurity

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Technology Integration and Platforms is top investment priority

	2023	2024
1	Technology integration and platforms	Technology integration and platforms
2	Customer digital experience	Customer digital experience
3	Brand awareness and advertising	Fraud mitigation

technologies can help banks straddle the fine line between safety and convenience.

"More has to be done about shutting the doors on fraudsters without shutting the door to a good customer experience," Nelson says.

The technology creating the most buzz is AI, which banks have embraced and are expected to aggressively apply in a variety of areas—from reallocating employees in the organization based on skillsets to offering investment advice to customers.

"Banks are in the early stages of even understanding where AI should be applied within their organizations," Nelson says.

BAI's Mark Riddle says "the first customer-facing step for AI would be solving a problem customers have with an account, which is normally done by humans in the branch or over the phone today. In my mind, this is the best place to start with AI."

Fraud mitigation breaks into Top 3 investment priorities

Like any bank or credit union, PNC takes a comprehensive approach to fraud mitigation. It has no choice. "There's no shortage of people with bad intentions trying to get consumers' money," says PNC's Todd Barnhart, who marvels at the amount of brain power and creativity that fraudsters devote to their scams.

Complicating the fight against fraud, he says, is "the proliferation of the speed of money movement and the digitization of so many interactions. It just invites fraud."

Barnhart adds that "some of the old scams are new again, such as check fraud and ATM skimming. And there are very sophisticated digital schemes to the very unsophisticated schemes such as counterfeit checks and stolen identities."

Customers are equally alarmed. The Millennial, Gen X and Boomer+ generations all identified security and becoming a victim of fraud as their No. 1 frustration with digital banking. For Gen Z, that concern was No. 2 behind the lack of personalized recommendations from their banks.

"We remind bankers all the time that you're not just mitigating fraud for your own sake but to put your customers at ease," says BAI's Isio Nelson. "Make it clear what you're doing to help them avoid becoming victims of fraud."

AI is being increasingly applied for fraud identification and mitigation, according to BAI's Mark Riddle. "Like consumers, bankers would also like to see less fraud and to drive more new account opening activity to digital and away from the branch. Therefore, it's the perfect alignment of consumer and banker frustrations that should help drive innovation and solutions in fraud mitigation for 2024."

Consumers biggest frustration with digital banking

	Gen Z	Millennial	Gen X	Boomer+
1	No personalized recommendations	Security / victim of fraud	Security / victim of fraud	Security / victim of fraud
2	Security / victim of fraud	Technology changes too much	Technology changes too much	Technology changes too much
3	Experience is too slow	No personalized recommendations	No personalized recommendations	No personalized recommendations
4	I am not able to open new accounts online	Experience is too slow	Experience is too slow	I do not understand digital banking

Conclusion

The punch list for banking leaders in 2024 can look a bit intimidating. Priorities include:

- **Attract and retain deposits.** It sounds like business as usual. But that's no longer true now that it's easier than ever for consumers to open and close accounts almost instantly online. If interest rates remain high, count on more defections by depositors in search of unusually high-yield alternatives.
- **Acquire new customers.** This has always been challenging, but even more so amid the rise of direct banks. They are especially appealing to younger consumers accustomed to the three-click convenience of the best-in-class retailers they've come to know. Gen Z and Millennials may not have a wealth of deposits today, but they own the future.
- **Enhance the customer digital experience.** Start by breaking down the silos. Then provide a friction-free experience that features no fees, competitive rates and 24/7 customer service.
- **Repel the fraudsters.** Customers are rattled by the increase in fraud in every banking channel, undermining trust in the entire baking system. Be transparent about your organization's efforts to mitigate the work of bad actors. AI can help.
- **Personalize the offerings.** AI can help here too. All generations indicate that one of their prime frustrations with digital banking is the lack of offers customized to their needs. More than half of Gen Z and Millennial consumers say they're amenable to advice generated by AI. Even a third of Boomers+ say they're comfortable with it.

This Special Report on 2024 Trends has given you a lot to think about. But we are confident it provides the kind of information that will help financial services organizations successfully navigate the challenges in the year ahead.

To learn more about banking strategies to drive smarter business decisions, visit

bai.org/research

or talk to an expert today.