WHAT`S GOING ON IN BANKING

Finding the Next Wave to Ride

2024

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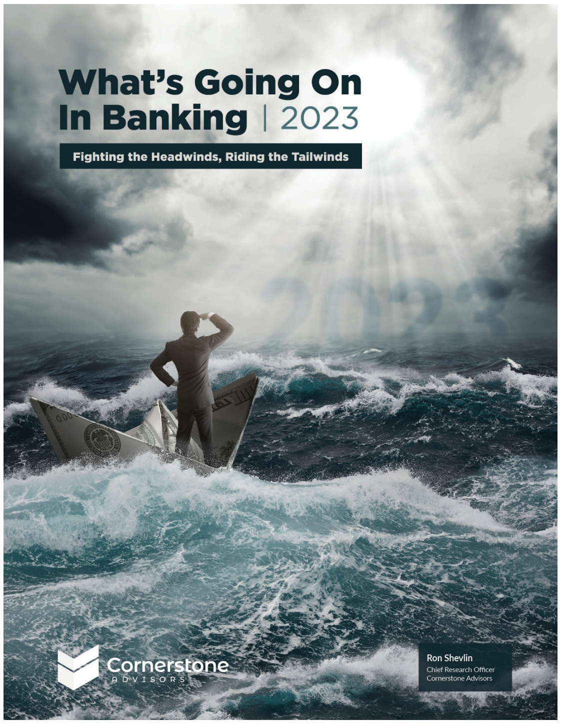
Trouble Ahead, Trouble Behind

And you know that notion just crossed my mind. Welcome to the ninth edition of Cornerstone Advisors' "What's Going On In Banking" study.

The theme of the 2023 report was "Fighting the Headwinds, Riding the Tailwinds" (Figure 1). The premise was that going into 2023, banks and credit unions were fighting headwinds like the interest rate environment, staffing challenges and competitive threats from fintechs. In addition to the headwinds, however, there were positive forces at play in the industry pushing financial institutions ahead, like banking as a service (BaaS) and artificial intelligence technologies.

Figure 1: What's Going On In Banking 2023 Cover Page



Source: Cornerstone Advisors

Just as nobody expected the Spanish Inquisition, nobody expected the Silicon Valley Bank debacle or the other high profile bank failures that occurred last year. The result of these developments—compounded by the rapid rise in interest rates—produced the banking crisis of 2023, which included a rise in:

- **Deposit costs.** High interest rates forced many banks to pay more to retain deposits (often via brokered deposits), while many institutions have seen deposits flee to higher-yielding money market funds.

- **Bond losses.** Rising interest rates depress the value of low-rate securities and loans. Banks had more than $500 billion in unrealized losses on their securities at the end of March 2023.

- **Commercial real estate loan losses.** Banks are anticipating losses in their commercial real-estate portfolios. Many midsize institutions, with a heavy concentration of commercial real estate loans in their portfolios, could be impacted by the low occupancy rates in commercial real estate.

The crisis of 2023 may be abating, but the banking industry is still in the throes of the "Crisis of the '20s," a crisis that will last the entire decade. This crisis touches banks' products, technologies, people, processes and the political climate. Here are five elements of the Banking Crisis of the '20s:

1) **Checking accounts ain't what they used to be.** In the first half of 2023, nearly half of the "checking accounts" opened in the United States were opened by digital banks and fintechs.

   I put quotes around checking accounts because bankers don't see offerings from companies like PayPal and Square as checking accounts. Young consumers, however, don't know the difference between a checking account and the Square Cash App account or PayPal payment account. They all enable consumers to make payments. Square's and PayPal's products, however, enable consumers to do a range of activities that would require them to open multiple accounts at banks.

   In addition, banks have learned—or are learning—that the checking account isn't the anchor product (for a broader relationship) they once thought it was. Without reinventing their product set, banks won't survive the Crisis of the '20s.

2) **Zombie cores.** A person's core has to be in shape, and so does a bank's. Getting their core systems into shape has become either a nightmare or an impossibility for banks. The bank technology landscape is littered with what Cornerstone Advisors' Steve Wildman calls "zombie cores"—core apps that haven't been sunsetted but are no longer supported or enhanced by the tech companies that provide them.

   Banks have two options throughout the rest of this decade: core replacement or core modernization. Neither option is cheap, and neither option is fast. The good news for banks is that this situation has given rise to a new category of tech firms—let's call them core integration platforms—promising to make it easier to integrate ancillary systems to existing cores and create a strategy for core replacement.

3) **The people shortage.** Core integration platforms are a good thing for banks, but the new reality is that banks will still need people to put things together. The (midsize) bank or credit union IT department has evolved from being a builder to a vendor management team and will evolve further in this decade to become an integration team. Finding these people—and others who bring expertise in technologies like machine learning, conversational AI and generative AI—will be the number one challenge for banks throughout the rest of the decade. The amount of work and positions that will need to be outsourced or partnered for means the typical bank may find that nearly half of the people working "with the bank" don't work "for the bank"—or even "at the bank."

4) **The creativity imperative.** Every management fad has a life cycle, and the innovation fad is on its last legs. For the past five years or so, banks have obsessed over "innovating." Other than an ad hoc innovation team led by someone with a lofty chief innovation officer title, few banks have truly created any innovations.

   That isn't to say that they haven't made a lot of internal changes and improvements, but many of these efforts don't live up to the innovation label. Banks need to stop playing innovation charades. With the influx of new technologies, the challenge isn't "innovation" but "creativity"—how can they, at an organizational level, make more creative use of data and technology than their competitors, and how can they help their people become more creative in getting their jobs done.

   An unforeseen (by most people) development in 2023 was the industry's infatuation with generative AI and specifically ChatGPT, which was introduced at the end of November 2022. These technologies will have a huge role to play in helping financial institutions become more creative.

   I'm not convinced, however, that most financial services executives really know what generative AI is (and isn't). We'll have a lot more to say about generative AI—and AI technologies, in general—later in the report.

5) **The political element.** For some politicians (you know who they are), banks are the scapegoats for society's ills. Increased regulations from a bank-unfriendly government works against all the things banks need to do the survive and thrive in the Crisis of the '20s.

Catch a Wave and You're Sitting on Top of the World

So where is the banking industry headed in 2024?

Well, for some financial institutions, nowhere. To continue the "sea" analogy, 2023's headwinds and tailwinds blew financial institutions into a windless cove, where they're riding out the storms brewing in the middle of the sea. For 2024, smart banks and credit unions will be looking for the next wave to ride towards a new future and destination.

The headwinds aren't behind us, however, as economic conditions are still uncertain.

Although the probability of a recession this year is down to 39% from 48% in October 2023, according to a survey of economists from *The Wall Street Journal*, those same economists expect the economy to grow by just 1% in 2024—down from 2.6% in 2023, and half of its normal long-run rate.

The good news on the economic front, however, is that many economists expect the Fed to cut interest rates throughout 2024. According to Bank of America CFO Alastair Borthwick, "There's been an awful lot of time for deposit pricing to shake out. If we do have rate cuts, it's going to disincent people moving out of noninterest-bearing deposits."

Smart banks and credit unions—no, make that smarter banks and credit unions—will be looking for (actually, creating) the wave to ride out the crisis of the '20s. A wave that will bring technological, societal and business model change.

And the Survey Says …

Let me say a little about the survey sample of this report. This year's sample included 359 respondents from financial institutions, 92% of whom work for financial institutions in the $250 million to $50 billion asset range. Fifty-four percent of respondents were from banks, 46% from credit unions. Nearly three-quarters of respondents are C-level executives with the rest coming from the ranks of executive vice presidents, senior vice presidents and vice presidents.

With roughly 3,100 banks and credit unions in this asset range, the margin of error on the study is 5% at a 95% confidence level. That's an acceptable margin of error, and it could be argued that the survey results are representative of the overall bank and credit union population in the asset range listed above. It may surprise you to know, however, that I don't believe the sample is representative of the overall population.

Instead, I believe the sample represents financial institutions that are forward-thinking about technology, aggressive about going after growth and market share, and unafraid to take on the megabanks, upstart fintechs and anyone else competing with them for mind and market share.

If You Plant Ice, You're Gonna Harvest Wind

The purpose of the report is to help both financial institutions and the technology companies that serve and partner with them better understand what's going on in the industry and plan for the changes. Like farmers who must plant seeds to see their crops grow, bankers must plant the seeds of their future capabilities and strategies. If they plant ice, they'll harvest wind. At least that's what the Grateful Dead said (the rest of the musical references you'll have to find on your own).

Last thing before you get into the meat of the report: The title of the report was inspired by the Marvin Gaye classic, "What's Going On," and like last year's report, this year's edition includes many subtle (OK, not so subtle) musical references—I hope you find them all. There have already been three references.

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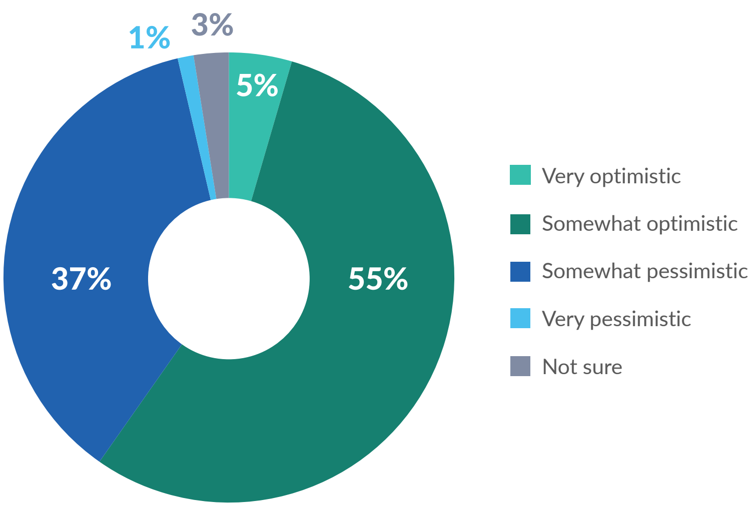
Brave the Storm to Come, for It Surely Looks Like Rain (or Does It?)

Compared to 2023, more bankers are optimistic about the industry's prospects for the coming year. Six in 10 are optimistic—whether "very" or "somewhat"—for 2024, up five percentage points from last year's report (Figure 2). This may be "guarded" optimism, however, as the percentage who are very optimistic dropped from 8% for 2023 to 5% for 2024.

Figure 2: Outlook for 2024

How optimistic or pessimistic are you about the prospects for the banking industry in 2024?

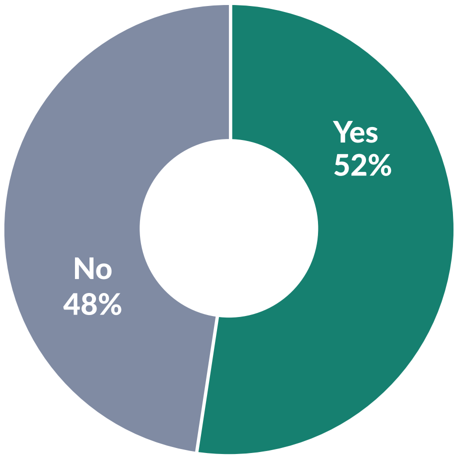


Source: Cornerstone Advisors survey of 359 community-based financial institution executives, Q4 2023 and Q1 2024

Survey respondents are nearly evenly split regarding the prospect of a recession in 2024 (Figure 3). Not all pessimists think a recession is likely, however—3 in 10 of them think there won't be a recession. And among the industry optimists, 42% think there will be a recession, leaving 58% who believe we'll avoid a recession this year.

Figure 3: Likelihood of an Economic Recession

Do you anticipate a recession or downturn in the economy for 2024?



Source: Cornerstone Advisors survey of 359 community-based financial institution executives, Q4 2023 and Q1 2024

What's influencing bank and credit union executives' optimism and pessimism for 2024? This report includes a variety of quotes from survey participants, some of whom chose to remain anonymous.

1) The Economy

> "In Janet Yellen we trust! She will force JPOWs hand in reducing interest rates 200 basis points before next year's election. Election years are almost always positive for the economy and stock market. Janet will protect her legacy with even more QE and less QT if she has to. After three years of bond market routs, I expect bonds to be a big winner in 2024 as we get back to a more normal yield curve."
>
> —Luke Labbe, President, PeoplesChoice Credit Union

> "Everything comes in cycles, and my sense is that 2024 will be a somewhat difficult year for a variety of reasons Personal savings rates are dropping as spending continues, housing affordability is at historic lows, credit card debt is at record highs, delinquencies and bankruptcies are on the rise, and 401(k) hardship withdrawals and the use of BNPL is on the rise. The only thing that seems to be holding it together is low unemployment. If that changes, it could unravel."

> "Strong labor market continues to send good signals that income growth will continue its positive trajectory even if slowing just a little. The resilience of the consumer continues to be stronger and longer in duration than expected."

> "I believe consumer weakness will start to show and homeowners will use homes as ATMs to free up uncontrolled spending created by habits post-pandemic. Labor costs, combined with paying more for less in terms of deposits, will be crippling for margins."

“While we continue to have economic pressures, the inflationary pressure is starting to ease with an optimistic hope that a soft landing is plausible. With lower interest rates and improved market for home loans, we hope to see better earnings than in 2023.”

“Net interest income pressure from interest expense is increasing faster than loans are repricing. Interest expense is increasing from the deposit mix shift from non-maturity deposits to higher cost CDs. The recent decline in longer-term rates isn’t sufficient to contribute to refinance volumes.”

2) Liquidity and Margins

“Liquidity will continue to prove challenging, and charge-offs will rise, but those institutions that have positioned themselves accordingly should not be impacted too harshly.”

“Extension of the Fed’s Bank Term Funding Program is imperative to ensure continued liquidity in institutions with high unrealized losses. With recent inflation, GDP and unemployment all looking favorable, a recession is less likely. That also may mean that rate cuts are unlikely. It’s an interesting time where income is compressed in the same period where tech investment and talent are at their highest importance and cost.”

—Jill Castilla, CEO, Citizens Bank of Edmond

“We expect falling rates, continued strong loan growth and newer software upgrades to provide efficiency and speed of delivery. At the same time, we have liquidity challenges, consumer fraud is very high, competition is coming from every direction, and we are always worried about cybersecurity.”

3) Industry Dynamics

“Midsize and smaller community banks and credit unions are being squeezed out of the market at an even faster rate. So many forces working against us, there are more and more times when I feel like I’m on the Titanic.”

“Financial institutions continue to be squeezed on both sides after record rate increases blew up existing ALM models. Between a high cost of funds, increased rates of charge-off and a material slowdown of lending engines outside of unsecured consumer debt, it makes for a difficult 2024. Coupled with a dramatic increase in operating expense due to inflationary pressures, it is a recipe for further industry consolidation.”

—Jack Ingram, CIO, Whatcom Educational Credit Union

“I do believe that rates have plateaued and that interest rates in relation to mortgages and HELOCs will begin to come down, allowing the housing market to rebound in regards to sales volume. At the same time, cash departures at banks will slow down, and those banks that won the ‘deposit sweepstakes’ will now start lending more and decreasing any borrowings to bring their NIM back in line.”

> “Deposit growth and high cost of funds are having a severe negative impact on profitability and liquidity pressures.”
>
> —Mark Wiete, CFO, Premier Members Credit Union

> “The maneuvers banks needed to take to shore up deposit outflows by locking in very high term deposit interest rates will likely outrun the period of high interest rates on loans that will be repricing or refinancing lower for the better part of 2024, squeezing margins further before they improve when those term deposits finally mature very late in the year or beyond.”

4) The Regulatory Environment

> “The federal government’s policies are hurting all sectors of the economy.”

> “The regulatory environment is spiraling in the wrong direction and will have a significant impact on all banks but especially small community banks. The CFBP is particularly egregious in their approach.”

> “Government is looking to pass the Credit Card Competition Act, which is a waste of time.”

> “Regulatory overreach will make the job more complicated and expensive, with an advantage to the largest banks. Funding costs will continue to pinch interest margins, and fintechs will continue to erode market share from banks.”

Optimistic or pessimistic, there should be little disagreement with this comment from Tom Moran, CEO, CommunityBank (OR/WA):

> “2024 is going to be a challenging year. Lace up your boots and get to work.”

Don’t You Worry ’Bout a Thing

Fewer than 1 in 10 bankers listed cost of funds as one of their top concerns for 2021 and 2022. That percentage jumps to 7 in 10 for 2024, making it the most frequently cited concern for the coming year (Table A and Table B). Other top concerns for the new year include:

- **Expenses.** Rising in the charts for 2024 are efficiency, noninterest expenses and costs, mentioned by about half of executives, up from 3 in 10 in 2023.
- **Growth.** Customer/member growth will be a big concern for financial institutions this coming year, seeing a big jump in mentions from both bank and credit union executives.
- **Deposits.** We added a few new concerns to our list for this year’s survey, which turned out to be a good move since nearly half of survey respondents checked off deposit gathering as a top concern (surprise, surprise).
- **Fraud.** Fraud is also on executives’ minds for 2024, as consumer-related fraud will be a top concern for 3 in 10 bankers and 37% of credit union execs.

Table A: Bank Execs' Top Concerns, 2021 to 2024

Percentage of Banks Listing Concern as One of Their "Top Concerns"

	2021	2022	2023	2024
Cost of funds	8%	8%	43%	70%
Interest rate environment	56%	50%	53%	53%
Efficiency, noninterest expenses, costs	36%	39%	28%	53%
Deposit gathering	NA	NA	NA	48%
Cybersecurity	28%	51%	36%	42%
New customer growth	25%	28%	23%	40%
Noninterest income	17%	29%	26%	32%
Consumer-related fraud	NA	NA	NA	30%
Ability to attract qualified talent	19%	67%	42%	26%
Credit quality/problem loans	42%	6%	7%	23%
Weak economy/loan demand	48%	36%	35%	21%
Small business-related fraud	NA	NA	NA	15%

Source: Cornerstone Advisors surveys of bank and credit union senior executives, 2020 to 2024

Table B: Credit Union Execs' Top Concerns, 2021 to 2024

Percentage of Credit Unions Listing Concern as One of Their "Top Concerns"

	2021	2022	2023	2024
Cost of funds	8%	9%	47%	71%
New member growth	40%	41%	36%	56%
Efficiency, noninterest expenses, costs	25%	33%	29%	52%
Deposit gathering	NA	NA	NA	49%
Cybersecurity	26%	43%	35%	48%
Noninterest income	27%	39%	34%	48%
Interest rate environment	53%	38%	59%	45%
Credit quality/problem loans	33%	4%	16%	37%
Consumer-related fraud	NA	NA	NA	37%
Weak economy/loan demand	57%	34%	44%	29%
Ability to attract qualified talent	19%	63%	39%	23%
Small business-related fraud	NA	NA	NA	1%

Source: Cornerstone Advisors surveys of bank and credit union senior executives, 2020 to 2024

One surprise in this year's survey is the decline in the percentage of executives mentioning the ability to attract talent as a top concern, dropping from about 4 in 10 in 2023 to about a quarter in 2024. Our interpretation here is not that it's getting easier for banks and credit unions to find and attract talent, but that their hiring plans have diminished and they're not as much in the market for new employees as they were a year or two ago.

We Gon' Save That Money

No big surprise that streamlining workflow for more efficiency is at the top of the list of efficiency and cost savings priorities for banks and credit unions in 2024 (Table C and Table D). A couple of the results caught our eyes, including those regarding:

- **Contracts.** The percentage of banks citing renegotiating vendor contracts as a cost savings priority grew from 18% in 2023 to 31% for 2024. But among credit unions, that percentage dropped from 30% to 21%. Are credit unions missing opportunities to reduce IT costs by overlooking contract renegotiations?
- **Headcount.** Only 17% of bank execs cited headcount reduction as a cost saving priority, but that is up from 7% in 2023. What was more newsworthy, however, is the increase in the percentage of credit union execs looking for headcount reduction in 2024. Historically, credit unions have been loath to cut costs by cutting headcount.

Table C: Bank Execs' Top Efficiency and Cost Savings Priorities, 2023 to 2024

What are your institution's three most important efficiency and cost savings priorities?

	2023	2024
Streamline workflow for more efficiency	78%	72%
Improve efficiency ratio/become more efficient	66%	57%
Improve reporting to reveal operating costs and inefficiencies	43%	39%
Renegotiate vendor contracts for savings	18%	31%
Reduce reliance on paper throughout the institution	30%	18%
Reduce headcount	7%	17%
Reduce branch-related expenses	19%	16%
Defer new projects	12%	11%

Source: Cornerstone Advisors surveys of bank and credit union senior executives, 2022 to 2024

Table D: Credit Union Execs' Top Efficiency and Cost Savings Priorities, 2023 to 2024

What are your institution's three most important efficiency and cost savings priorities?

	2023	2024
Streamline workflow for more efficiency	82%	71%
Improve efficiency ratio/become more efficient	57%	58%
Improve reporting to reveal operating costs and inefficiencies	38%	40%
Renegotiate vendor contracts for savings	30%	21%
Reduce reliance on paper throughout the institution	21%	15%
Reduce branch-related expenses	19%	15%
Reduce headcount	6%	13%
Defer new projects	12%	13%

Source: Cornerstone Advisors surveys of bank and credit union senior executives, 2022 to 2024

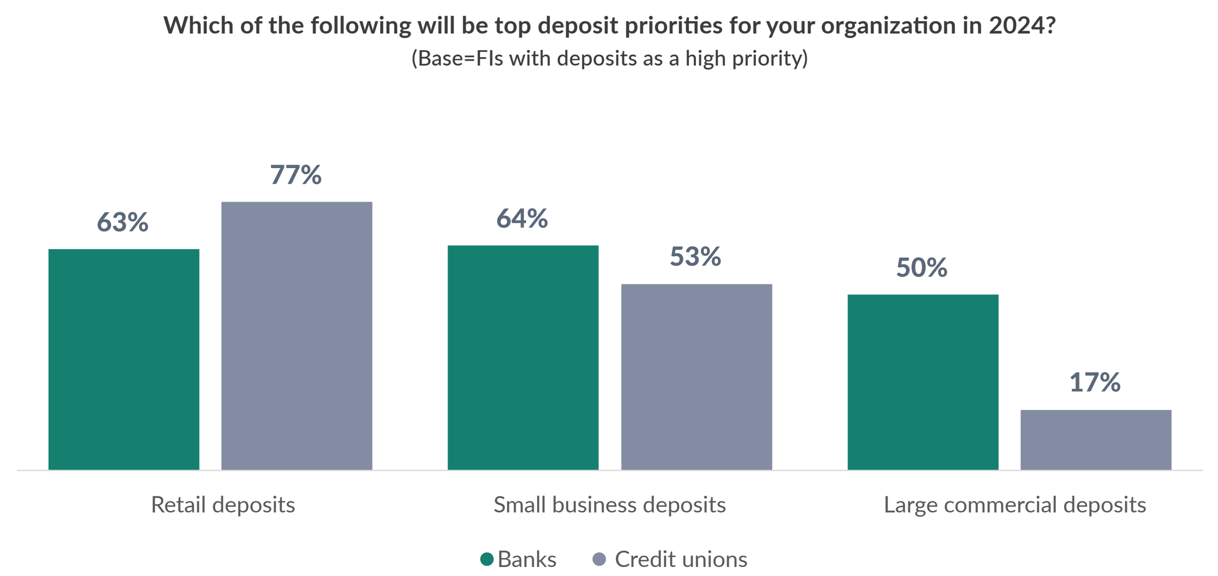
I Got 10 Bank Accounts Plus a Main Account with Insane Amounts

We don't need to convince midsize banks and credit unions that deposit gathering will be a difficult task, despite the comments from Bank of America's chief financial officer. A study from professors at some leading universities examined the differences between deposit activity at large versus small banks and concluded:

> "Large and small banks operate different production functions for their deposit franchises and serve customers with different preferences over deposit rates versus liquidity services. Much of the variation in deposit pricing behavior across banks may be due to variation in preferences and technologies, as opposed to being driven purely by pricing power derived from the large observed degree of concentration in the banking industry."

Not surprisingly, roughly three-quarters of banks will focus on growing retail and small business deposits, and half will look to grow large commercial deposits. More surprisingly, perhaps, is that about half of credit unions will put an emphasis on increasing small business deposits, an area in which they have not been typically strong (Figure 4).

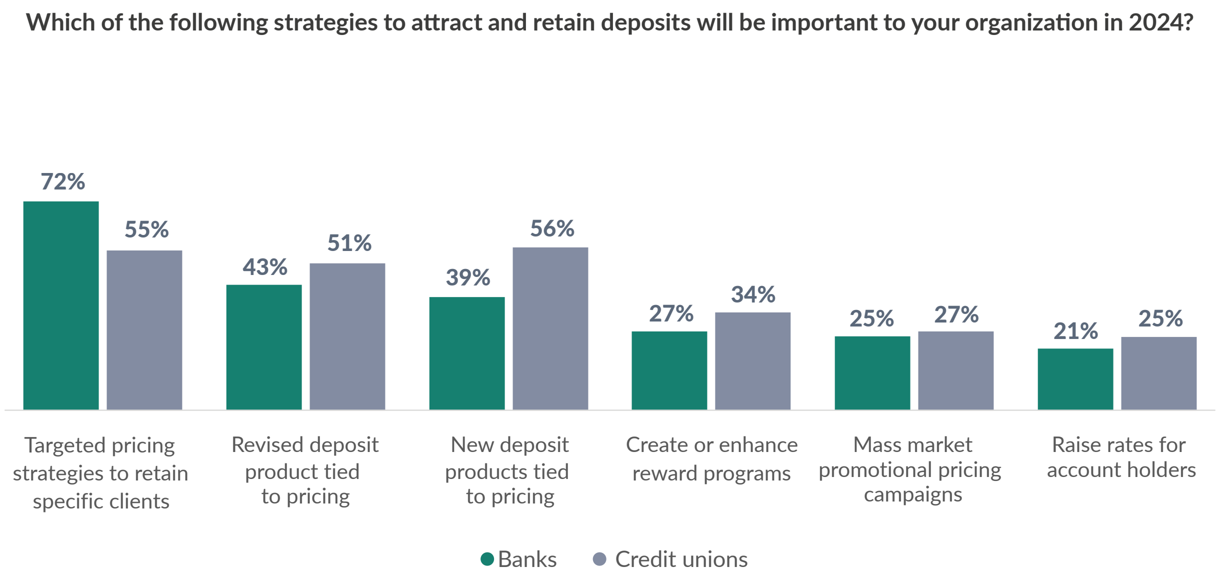
Figure 4: Deposit Priorities



Source: Cornerstone Advisors survey of 359 community-based financial institution executives, Q4 2023 and Q1 2024

So, what will midsize banks and credit unions do to attract deposits in 2024? For banks, targeted pricing strategies to retain specific clients will be the most popular strategy. Credit unions plan to do that as well, but creating new, and revising existing, deposit products tied to pricing will also be deployed (Figure 5).

Figure 5: Deposit Gathering Strategies



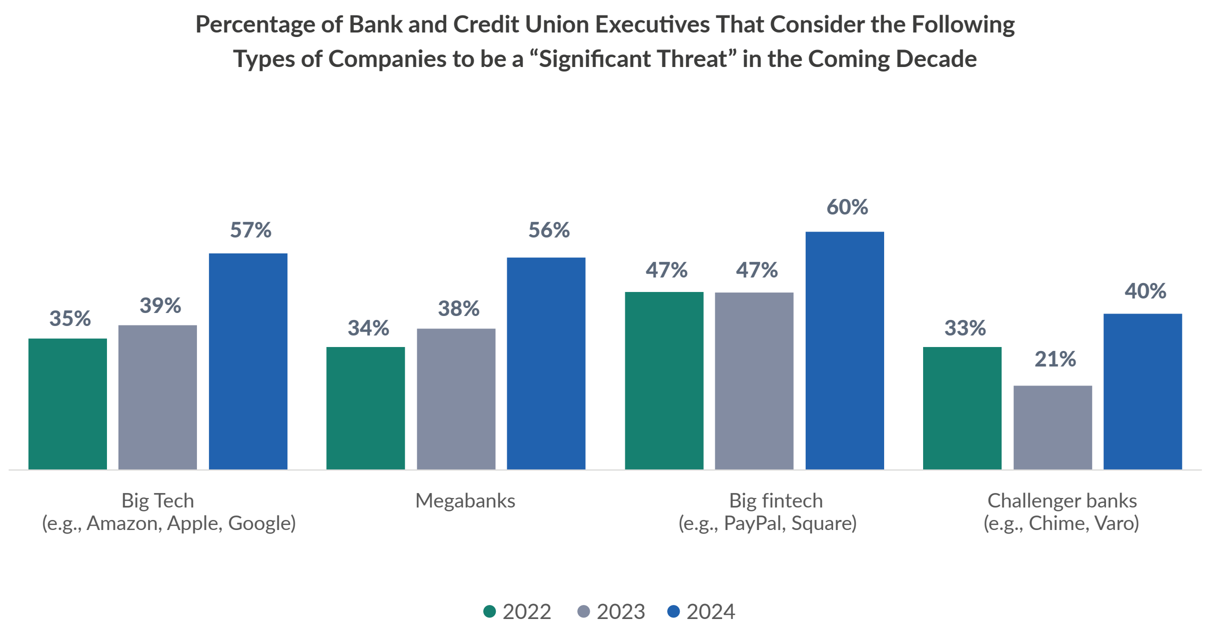
Source: Cornerstone Advisors survey of 359 community-based financial institution executives, Q4 2023 and Q1 2024

The Heat is On

It isn't just large banks that midsize institutions compete with for deposits and customers. Large fintechs, neobanks and even Big Tech companies like Apple have encroached on banks' and credit unions' turfs. Until this year, however, a minority of bankers have seen these players as significant threats. That changed going into 2024.

The percentage of bankers that now consider large fintechs, neobanks and Big Tech companies to be "significant threats" rose significantly from previous years. Even the threat from neobanks like Chime and Varo—which fewer executives saw as a threat in 2023 versus 2022—is now seen as significant by 4 in 10 bank and credit union executives (Figure 6).

Figure 6: Competitive Threats

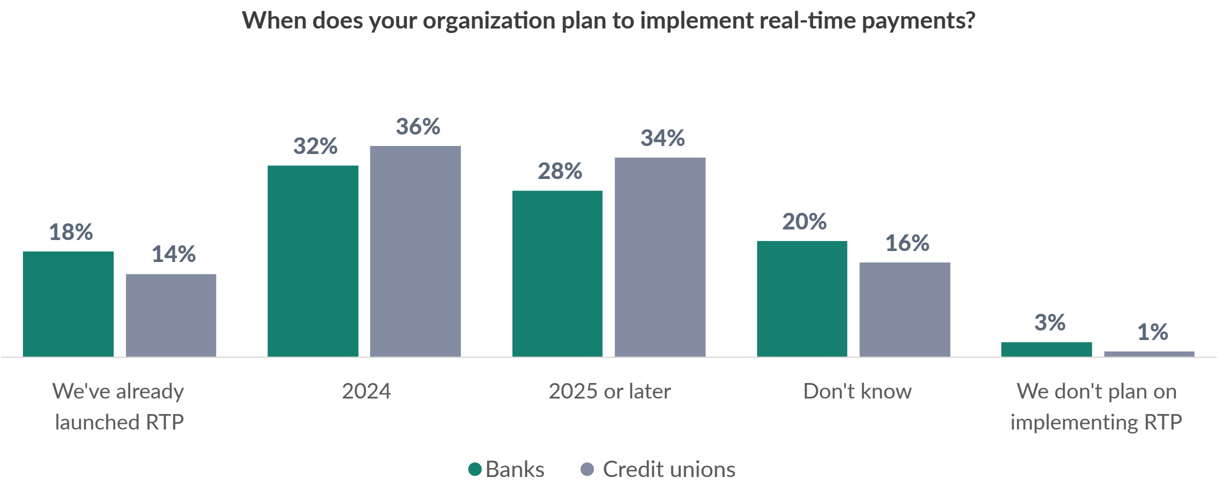


Source: Cornerstone Advisors surveys of bank and credit union senior executives, 2022 to 2024

Just Got Paid Today

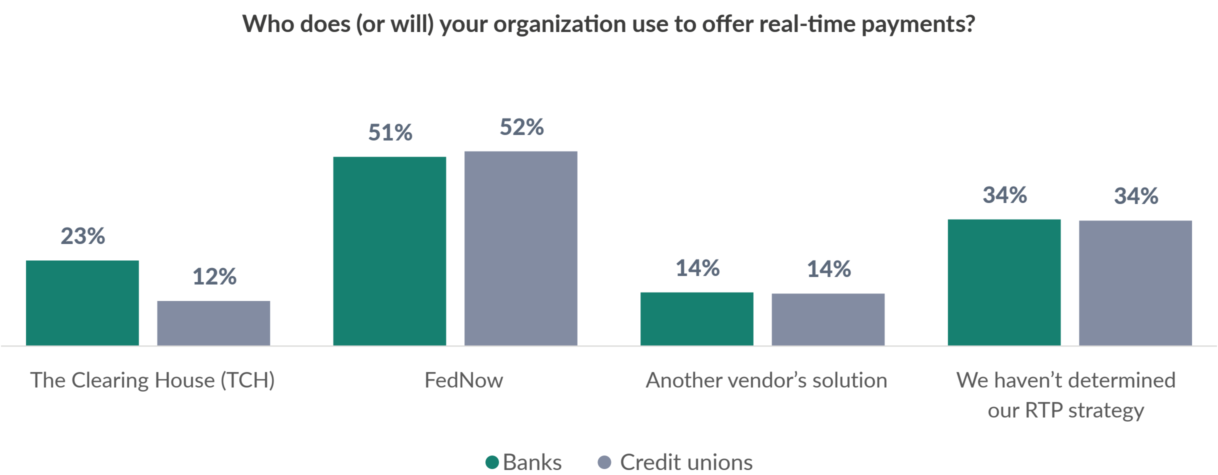
With the 2023 launch of the Federal Reserve's FedNow, real-time payments (RTP) has become a hot topic and high priority for banks and credit unions. If their plans come to fruition, by the end of 2024, 50% of banks and credit unions will be up and running with RTP (Figure 7). Roughly half of financial institutions plan to offer RTP through FedNow (Figure 8).

Figure 7: Banks' Deposit and Payments Priorities



Source: Cornerstone Advisors survey of 359 community-based financial institution executives, Q4 2023 and Q1 2024

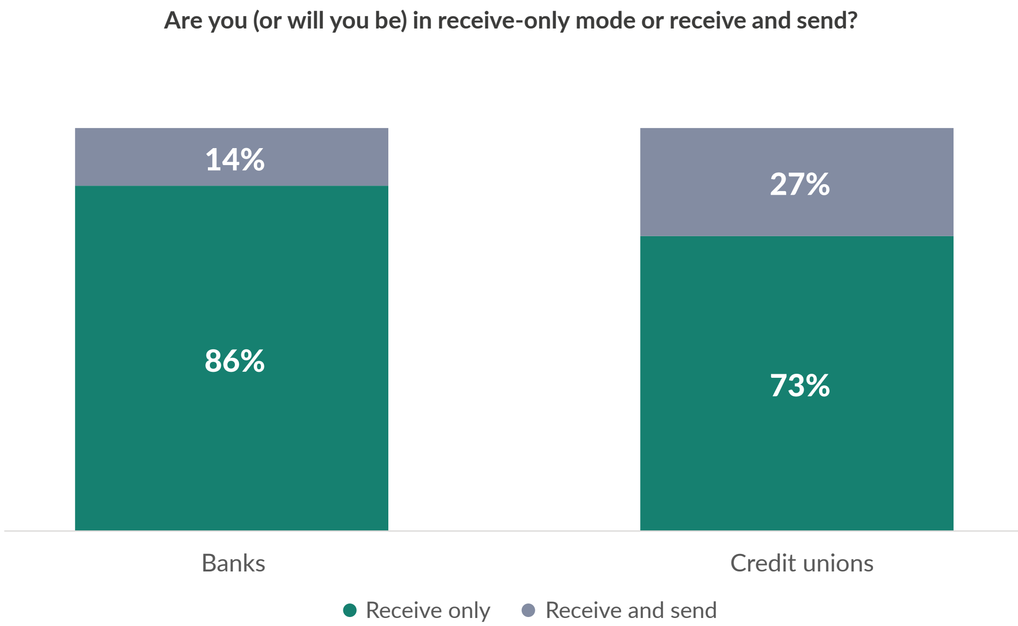
Figure 8: Real-Time Payments Providers



Source: Cornerstone Advisors survey of 359 community-based financial institution executives, Q4 2023 and Q1 2024

Among the financial institutions that have already launched RTP and those that plan to deploy in 2024, the majority are in (or plan to be in) receive-only mode (Figure 9).

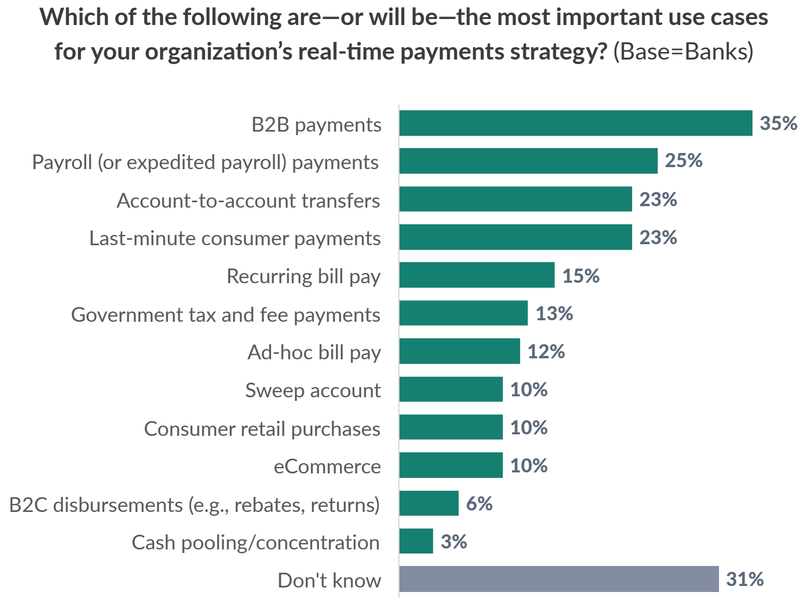
Figure 9: RTP Receive Versus Send



Source: Cornerstone Advisors survey of 359 community-based financial institutions executives, Q4 2023 and Q1 2024

B2B payments are one of the most important use cases for banks' RTP strategies (Figure 10). Compared to the 2023 survey, the percentage of banks mentioning last-minute consumer payments as an important RTP use case increased from 18% to 23% while the percentage citing account-to-account transfers declined from 38% to 23%.

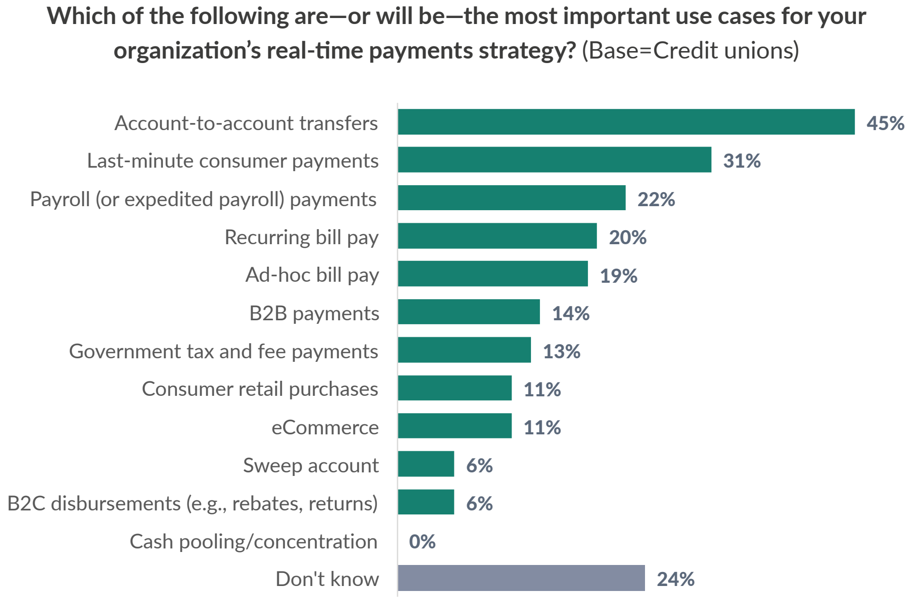
Figure 10: Banks' Real-Time Payments Use Cases



Source: Cornerstone Advisors survey of 359 community-based financial institution executives, Q4 2023 and Q1 2024

In contrast to the banks, 45% of credit unions consider account-to-account transfers to be the top use case for real-time payments (Figure 11).

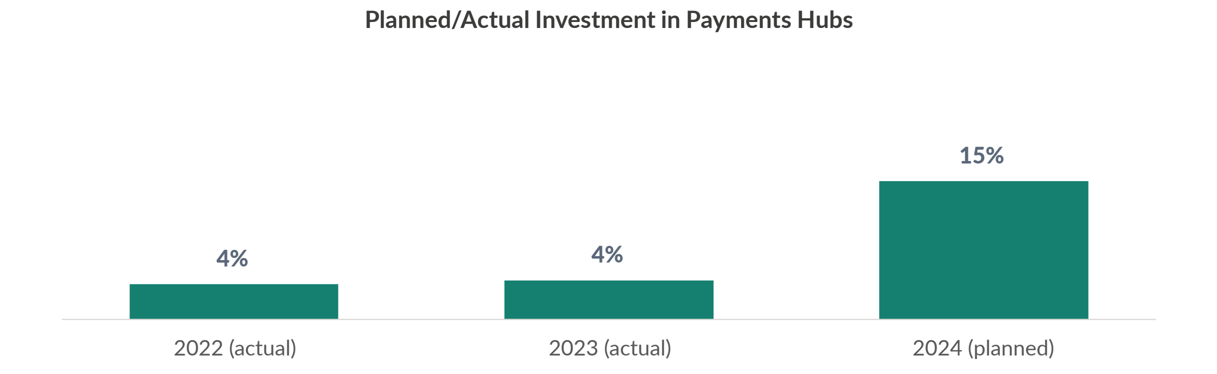
Figure 11: Credit Unions' Real-Time Payments Use Cases



Source: Cornerstone Advisors survey of 359 community-based financial institution executives, Q4 2023 and Q1 2024

Increased attention on real-time payments has helped stimulate interest in payments hubs. In both 2022 and 2023, just 4% of banks and credit unions selected a new or replacement payments hub. For 2024, the percentage that plans to invest in a new payment hub or replace an existing one jumps to 15% (Figure 12).

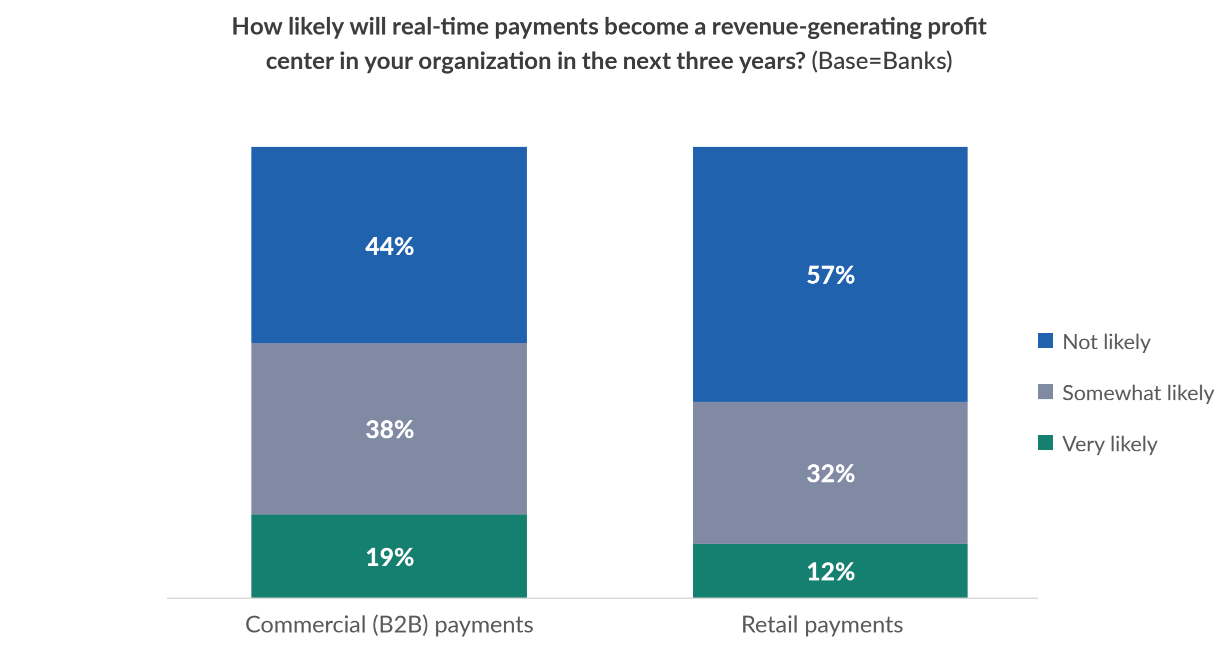
Figure 12: Investments in Payments Hubs



Source: Cornerstone Advisors survey of 359 community-based financial institution executives, Q4 2023 and Q1 2024

Nearly 1 in 5 banks anticipates that commercial RTP will become a revenue-generating profit center in the next three years while only about 1 in 10 expects retail RTP to generate revenue (Figure 13). Among credit unions, just 7% see either commercial or retail RTP becoming a profit center (Figure 14).

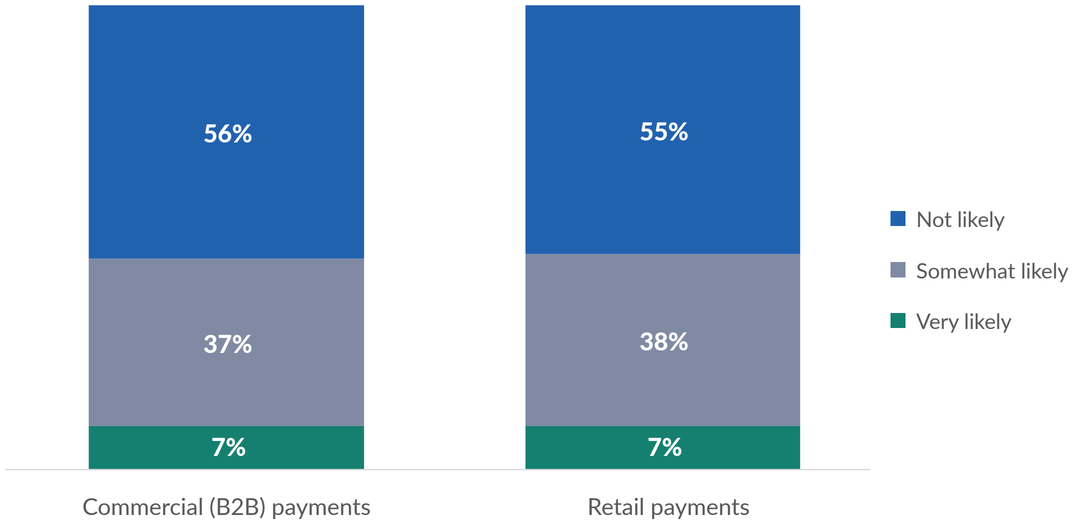
Figure 13: RTP as a Revenue-Generating Profit Center (Banks)



Source: Cornerstone Advisors survey of 359 community-based financial institution executives, Q4 2023 and Q1 2024

Figure 14: RTP as a Revenue-Generating Profit Center (Credit Unions)

How likely will real-time payments become a revenue-generating profit center in your organization in the next three years? (Base=Credit unions)



Source: Cornerstone Advisors survey of 359 community-based financial institution executives, Q4 2023 and Q1 2024

Let's Make Lots of Money

Banks are being short-sighted about the revenue opportunity from B2B real-time payments. Research from Accenture found that more than half of banks are losing wallet share—and revenue—to Big Tech and fintech competitors. In an article titled *The Payments Blindspot That Could Cost Banks Billions,* Accenture's Michael Abbott writes:

> "Commercial payments have been the sleepy backwater of payments. Most banks see commercial payments as a cost center rather than a source of growth. Now that interest rates have linked deposits with revenue again, banks should see commercial payments as tremendously valuable."

The Accenture study estimates that globally commercial payments providers have a $371 billion revenue opportunity from providing value-added services (of which real-time payments is one type of service) over the next five years.

Far from seeing instant payments as a revenue generator, many banks are concerned that real-time payments will result in a loss of revenue by cannibalizing their wire business, according to Tony Hayes, founder of the Banking & Payments Group. This concern is misplaced. Hayes points out that:

> "Businesses report a willingness to pay for speed, with ~$2.50 being seen as a fair price for sending $1,000, while nearly $100 is seen as reasonable fee for both sending and receiving $100,000 more quickly. Far from cannibalizing wire income, if priced correctly, real-time payments could boost forward-thinking banks' income."

"If priced correctly" is a big if, however. Pricing—particularly for fee-based services—is hardly a strong point for many financial institutions.

Hayes' comment "if priced correctly" begs the question: What, exactly, needs to be priced correctly?

At a recent payments conference, a number of bankers referred to FedNow as a "solution." This is a misconception. Better to think of FedNow as a "capability." You don't price—and sell—capabilities. You package capabilities into a solution—a "product" or "service offering"—then determine what pricing options are most attractive to your target market and market the solution to them.

Commercial banking clients—small businesses, in particular—don't simply want "faster payments." They want better cash management, simplified payments processing, automating invoicing, less cumbersome accounting processes, etc. Matt Brown, an investor at Matrix Partners, captured this idea in a recent blog post where he wrote:

> "B2B payments aren't payments, they're workflows. If you view B2B payments not just as a payment problem, but one at the end of a string of workflows, it creates more surface area to create a 10x solution by improving the preceding workflows rather than being limited to the payment itself."

This is what banks should be offering (that is, selling). From what I've seen and heard, however, there isn't a lot of thought going into how to create and price a faster payments solution. Bankers should be worried about this.

Bank marketing departments aren't (typically) pricing experts because banking is the only industry on the planet where pricing is done by the finance department, not the marketing department. To capitalize on the instant payments revenue opportunity, bank marketers will need to:

- **Segment the market.** Some businesses need faster access to capital, some prioritize integration into their accounting systems, while others have other needs that instant payments can address. How does a bank's commercial customer base fall out across the various needs? Which of these needs is the bank best suited to meet?

- **Design a product or service offering.** A faster payments product (or solution) is not simply a menu of FedNow transaction types. It's a bundling of capabilities into a cohesive and coherent package that solves a need for the market segment(s) a bank is looking to address. Creating this bundle might require a bank to partner with other providers—e.g., fintechs, accounting system providers, payment processors—to create the offering.

- **Determine pricing options.** Is a per-transaction charge really the best (and only) approach? How about a "subscription fee" that, for a fixed monthly price, offers a small business an unlimited number of faster payment-related transactions? The number of pricing options isn't infinite, but it's certainly not as simple as coming up with a list of transaction fees.

It's important for banks to recognize that the battle for commercial payments revenue growth isn't just among banks. Just 6 in 10 businesses said they would prefer to get real-time payments services from banks, with 37% naming fintech and Big Tech companies as their preferred providers, according to Accenture.

One of These Days I'm Gonna Pay It Back

The percentage of banks that said commercial C&I and real estate loans will be a priority for them in 2024 ticked up a few percentage points over 2023, but the big shift is the number of banks that will focus on mortgage and refis in 2024 (Table E). On the credit union side, auto loans continue to be a top priority, but the big shifts in credit unions' lending strategies for 2024 reflect: 1) a renewed focus on mortgages and refis and 2) a de-escalation of focus on commercial C&I loans after an increase in the previous two years (Table F).

Table E: Banks' Lending Priorities, 2021 to 2024

Percentage of Banks Citing Loan Type as a High Priority

	2021	2022	2023	2024
Commercial C&I loans	63%	57%	62%	67%
Commercial real estate loans	45%	53%	49%	57%
Mortgage/refi loans	47%	37%	20%	44%
Home equity loans/lines of credit	9%	20%	17%	24%
Microloans (e.g., less than $75K)	NA	NA	NA	17%
Sole proprietorship loans	6%	9%	6%	13%
Auto loans	5%	6%	3%	12%
Other personal loans	1%	5%	3%	10%

Source: Cornerstone Advisors surveys of bank and credit union senior executives, 2020 to 2024

Table F: Credit Unions' Lending Priorities, 2021 to 2024

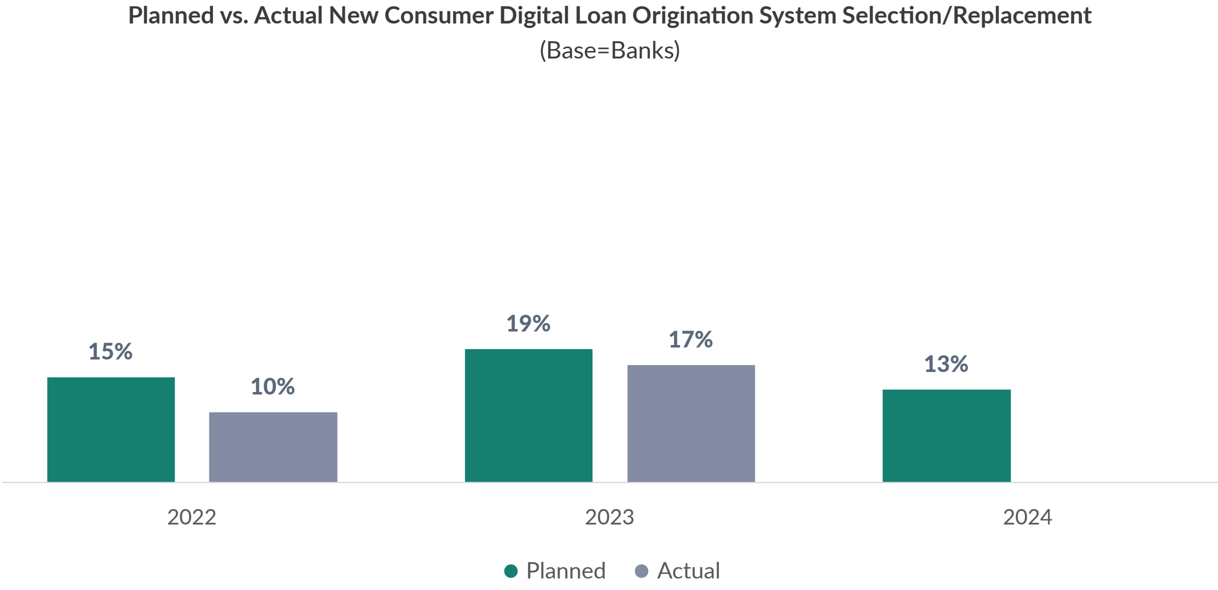
Percentage of Credit Unions Citing Loan Type as a High Priority

	2021	2022	2023	2024
Auto loans	72%	63%	68%	77%
Home equity loans/lines of credit	41%	56%	59%	65%
Mortgage/refi loans	79%	75%	30%	58%
Commercial real estate loans	30%	45%	33%	37%
Other personal loans	16%	21%	26%	29%
Commercial C&I loans	6%	20%	24%	15%
Microloans (e.g., less than $75K)	NA	NA	NA	12%
Sole proprietorship loans	3%	6%	5%	6%

Source: Cornerstone Advisors surveys of bank and credit union senior executives, 2020 to 2024

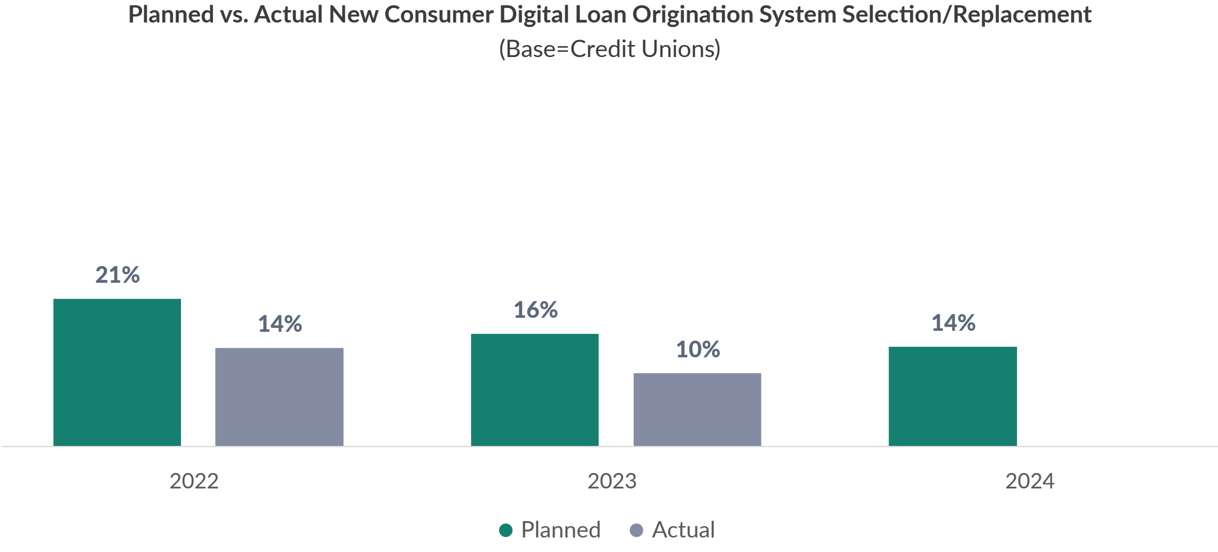
From a technology perspective, a roughly equal percentage of banks and credit unions plan to select a new or replacement digital consumer loan origination system (LOS) in 2024. Historically, however, their LOS eyes have been bigger than their wallets. In both 2022 and 2023, the percentage of financial institutions that actually selected a new or replacement consumer LOS fell short of those that planned to do so (Figure 15 and Figure 16).

Figure 15: Banks' Planned vs. Actual New Consumer LOS Selection/Replacement



Source: Cornerstone Advisors surveys of community-based financial institution executives, 2022 to 2024

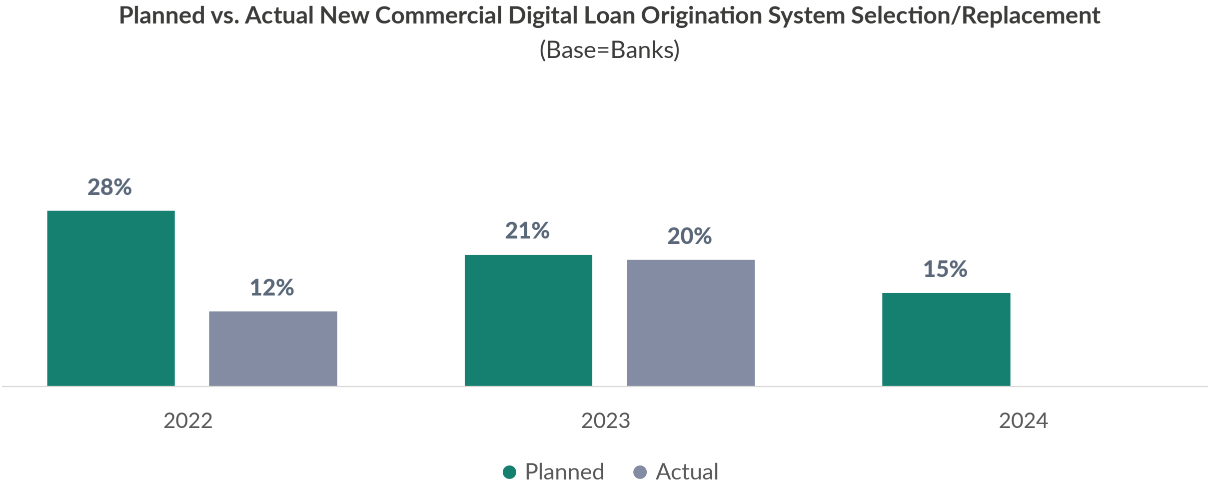
Figure 16: Credit Unions' Planned vs. Actual New Consumer LOS Selection/Replacement



Source: Cornerstone Advisors surveys of community-based financial institution executives, 2022 to 2024

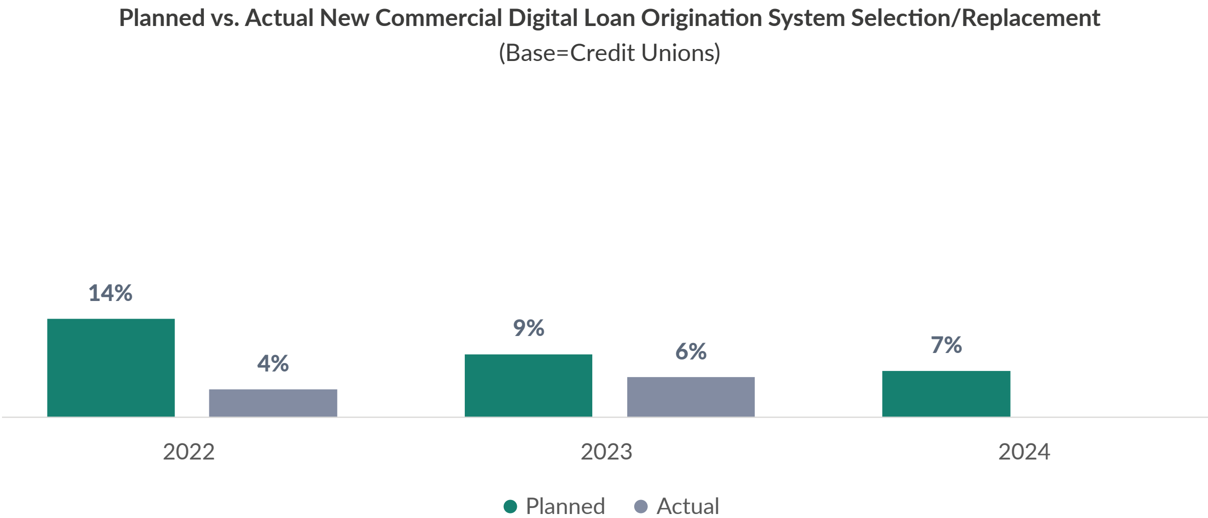
On the commercial LOS side, the story is somewhat similar as plans to select a new or replacement system outpaced the percentage of financial institutions that actual did so (Figure 17 and Figure 18). Not to disappoint LOS vendors, but the percentage of both banks and credit unions that are planning new or replacement consumer and commercial loan origination systems is down from previous years.

Figure 17: Banks' Planned vs. Actual New Commercial LOS Selection/Replacement



Source: Cornerstone Advisors surveys of community-based financial institution executives, 2022 to 2024

Figure 18: Credit Unions' Planned vs. Actual New Commercial LOS Selection/Replacement

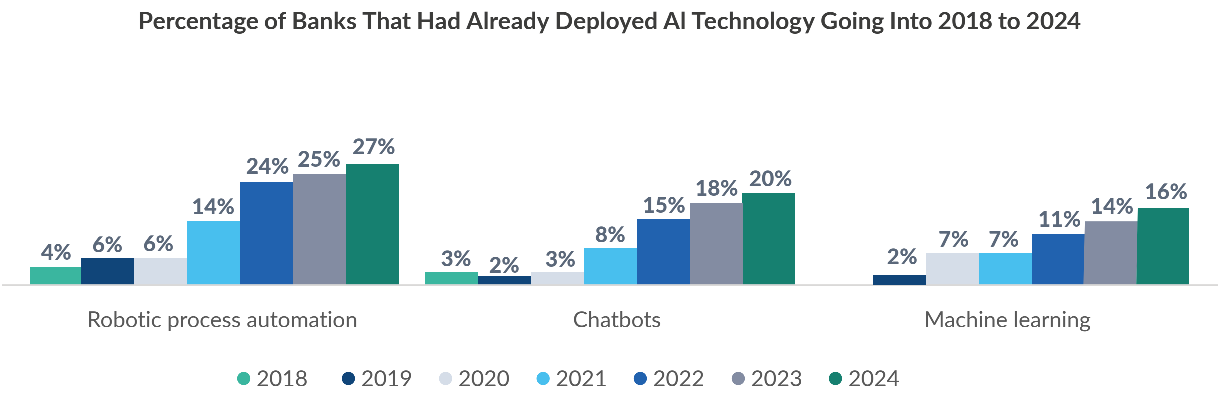


Source: Cornerstone Advisors surveys of community-based financial institution executives, 2022 to 2024

In the AI(r) Tonight

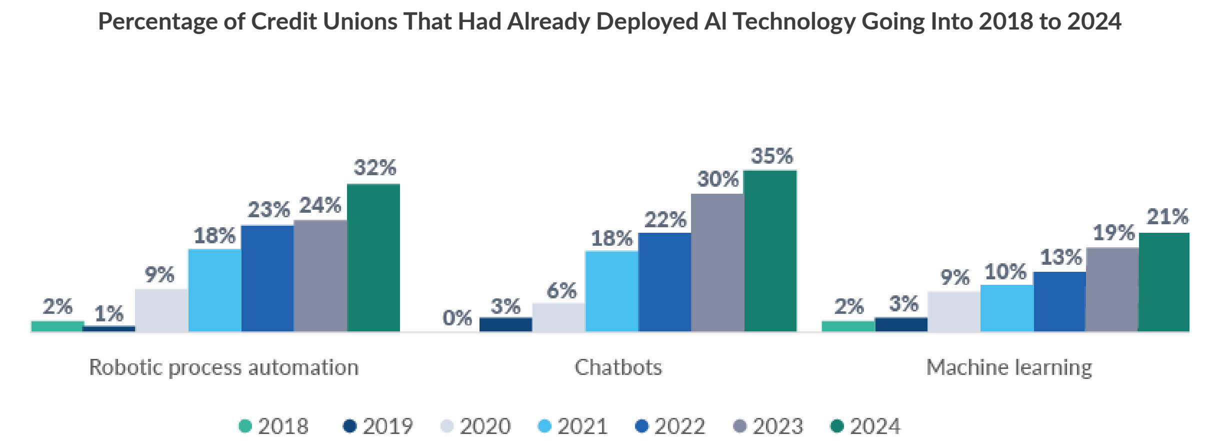
I can feel it coming in the air tonight. And not just tonight, but for the past few years. The artificial intelligence "revolution" is upon us. Since the pandemic of 2020, banks' and credit unions' investments in AI technologies like robotic process automation, chatbots and machine learning have increased. Heading into 2024, roughly a third of credit unions have already deployed RPA and chatbots, with banks a few clicks behind (Figure 19 and Figure 20).

Figure 19: Banks' Deployment of Artificial Intelligence, 2018 to 2024



Source: Cornerstone Advisors surveys of community-based financial institution executives, 2017 to 2024

Figure 20: Credit Unions' Deployment of Artificial Intelligence, 2018 to 2024



Source: Cornerstone Advisors surveys of community-based financial institution executives, 2017 to 2024

Financial institutions have big plans for AI adoption in 2024. Among banks, 16% plan to make first-time investments in RPA, and 13% plan to deploy chatbots for the first time. The percentage using machine learning would double if plans to implement the technology come to fruition, while the percentage planning to experiment with generative AI is double the percentage already using it (Table G).

Table G: Banks' AI Plans for 2024

	Have already invested in or deployed	Planning to invest and/or implement in 2024	Have discussed at the board or executive team level	Not on our radar
Robotic process automation	27%	16%	24%	34%
Chatbots	20%	13%	42%	24%
Machine learning	16%	17%	37%	30%
Generative AI	6%	14%	53%	27%

Source: Cornerstone Advisors survey of 359 community-based financial institution executives, Q4 2023 and Q1 2024

Credit unions are planning even more aggressive adoption of AI, with nearly 3 in 10 planning investments in chatbots, 1 in 5 planning to deploy RPA, and about a quarter expecting to test generative AI tools (Table H).

Table H: Credit Unions' AI Plans for 2024

	Have already invested in or deployed	Planning to invest and/or implement in 2024	Have discussed at the board or executive team level	Not on our radar
Chatbots	35%	29%	29%	6%
Robotic process automation	32%	20%	24%	24%
Machine learning	21%	18%	45%	16%
Generative AI	7%	24%	57%	12%

Source: Cornerstone Advisors survey of 359 community-based financial institution executives, Q4 2023 and Q1 2024

Talking ’bout My G-G-Generative AI

The hype around generative AI (and ChatGPT) isn’t unwarranted, but there are a lot of misconceptions about what generative AI is and what it’s going to do to and for banks and credit unions. Here are five things CEOs need to know about ChatGPT and generative AI:

1. Cost reduction is not the goal of generative AI.

The early focus of generative AI tool and technology deployment should be on productivity improvement, specifically process acceleration.

Estimates of staff cutbacks vary by type of role and position and range from 20% to even 80%. While there are isolated examples of companies completely (or nearly completely) replacing employees with generative AI, they’re few and far between—and the results have been less than spectacular.

The impact of generative AI on business isn’t staff replacement—it’s the acceleration of human productivity and creativity. According to Charles Morris, Microsoft’s chief data scientist for financial services: “Don’t think about gen AI as an automation tool, but as a co-pilot—humans do it, and the co-pilot helps them do it faster.”

From executing marketing campaigns to developing websites to developing code to create new data models, the benefits of these use cases for using generative AI isn’t cost reduction, it’s reducing time to market.

2. You have to evaluate large language model risks.

Although ChatGPT might currently be the most well-known large language model out there (Microsoft’s Gorilla and Facebook’s Llama are coming on strong), nearly every major technology vendor has an LLM in the works or has recently launched one.

By the end of the decade, you should expect to be relying on anywhere from 10 to 100 LLMs depending on your industry and the size of your business. There are two things you can bet on: 1) Tech vendors will claim to be incorporating generative AI technology in their offerings when they really don’t, and 2) tech vendors won’t tell you what the weaknesses and limitations of their LLMs (if they really have one) are.

As a result, companies will need to evaluate the strengths, weaknesses and risks of each model themselves. According to Chris Nichols, director of capital markets at SouthState Bank:

> “There are certain standards that companies should apply to each model. Risk groups need to track these models and rate them on their accuracy, potential for bias, security, transparency, data privacy, audit approach/frequency and ethical considerations (e.g., infringement of intellectual property, deep fake creation).”

3. ChatGPT was to 2023 what Lotus 1-2-3 was to 1983.

Remember the spreadsheet Lotus 1-2-3? Although it wasn't the first PC-based spreadsheet on the market, when it was introduced in early 1983, it sparked a boom in the adoption of personal computers and was considered the "killer app" for PCs.

Lotus 1-2-3 also sparked a boom in employee productivity. It enabled people to track, calculate and manage numerical data like nothing before it. Few people in the working ranks today remember how we (oops—I meant "they") had to rely on HP calculators to make calculations and then write stuff down.

Despite the huge gain in productivity, there were some issues: 1) Users hardcoded errors in calculations, which caused big problems for some companies; 2) documentation of the assumptions going into spreadsheets was weak (more like nonexistent), creating a lack of transparency; and 3) there was a lack of consistency and standardization in the design and use of the spreadsheets.

These same issues companies wrestled with 40 years ago with Lotus 1-2-3 are present today with the use of ChatGPT and other generative AI tools: There's a reliance on ChatGPT's often incorrect output, there's no documentation (or "paper trail") on the use of the tool, and there's no consistency in the use of the tool across employees in the same department, let alone the same company.

Back in its day, Lotus 1-2-3 spawned a number of plugins that enhanced the spreadsheet's functionality. Similarly, hundreds of plugins already exist for ChatGPT. In fact, much of the power to generate output like audio, video, programming code and other forms of non-text output comes from these plugins, not ChatGPT itself.

4. Data quality makes or breaks generative AI efforts.

Consultants have been urging you to get your internal data house in order for years, and when you start using generative AI tools, you'll see how well you've done. The adage "garbage in, garbage out" was tailor-made for generative AI.

For open source LLMs that use public internet data, you've got to be very wary of data quality. While the internet is a data gold mine, it's a gold mine sitting in the middle of a data landfill. Stick your hand in for some data, and you won't be sure if you've got a gold nugget or a handful of garbage.

Companies have wrestled—for decades now—with giving their employees access to the data they need to make decisions and do their job. Part of the challenge is having tools that access the data and getting employees trained and up to speed on them.

Generative AI tools help to abstract away some of the issues with using data access and reporting software applications. That's a big benefit (and one reason why these new tools help to accelerate human performance).

What's left, though, is the quality of the data.

Paradoxically, you need to stop talking about "data"—generically, that is. Instead, evaluate the quality, availability and accessibility of specific types of data—for example, customer data, customer interaction data, transaction data, financial performance data and operational performance data.

Each one of these types of data is fodder for generative AI tools.

5. Generative AI requires new behaviors.

You can't ban the use of generative AI tools. What you can—and should—do is to establish guidelines for their use. For example, require employees to: 1) document the prompts they use to generate results; 2) proofread generative AI output (and prove that they did); and 3) adhere to internal document guidelines that include the use of keywords, clear headings, graphics with alt tags, short sentences and formatting requirements.

That's a tall order, but according to SouthState Bank's Nichols, "Poorly structured documents cause the bulk of generative AI inaccuracies."

Management's focus will change over the rest of the decade as well.

Businesses have spent the past 10 years on a "digital transformation" journey, where the focus has been on digitizing high-volume transaction processes like account opening and customer support.

That focus is changing—expanding would be a better word—to enhancing the productivity of knowledge workers in the organization—IT, legal, marketing, etc.

In the short term, you'd be crazy to trust generative AI tools to run the company without human intervention and oversight. There's too much bad data leading to too many "hallucinations."

In the long run, generative AI will be "disruptive" and a "a game changer." CEOs need to be proactive and take big steps to ensure these disruptions and changes are positive for their organizations.

It Costs a Lot to Win and Even More to Lose

We imagine there are many chief financial officers in the banking industry who can't get no satisfaction. They try, and they try—to reduce tech spending—but they can't get no satisfaction. The largest percentage of banks we've seen in the history of this study will try to reduce their tech spend in 2024. A growing number—from 14% to 22%—expect to hold their spending level in line with 2023 (Table I). Fewer credit unions (just 4%) expect to reduce their tech spending in 2024, but like the banks, few are anticipating increases and will try to hold the line on their tech spend in 2024 (Table J).

Table I: Banks' Tech Spending Changes, 2021 to 2024

How will your institution's tech spending change in the upcoming year compared to the prior year?

	2021	2022	2023	2024
Significantly higher (>10% higher)	22%	23%	14%	8%
Somewhat higher (1%-10% higher)	51%	60%	64%	56%
No change	22%	14%	14%	22%
Somewhat lower (1%-10% lower)	5%	2%	9%	13%
Significantly lower (>10% lower)	1%	1%	0%	2%

Source: Cornerstone Advisors surveys of bank and credit union senior executives, 2020 to 2024

Table J: Credit Unions' Tech Spending Changes, 2021 to 2024

How will your institution's tech spending change in the upcoming year compared to the prior year?

	2021	2022	2023	2024
Significantly higher (>10% higher)	19%	25%	16%	14%
Somewhat higher (1%-10% higher)	58%	61%	66%	62%
No change	15%	12%	11%	20%
Somewhat lower (1%-10% lower)	5%	3%	5%	4%
Significantly lower (>10% lower)	2%	0%	2%	0%

Source: Cornerstone Advisors surveys of bank and credit union senior executives, 2020 to 2024

Where's the money going? Well, we can tell you where financial institutions expect the money to go—whether it gets there or not is another story. For both banks and credit unions, consumer digital account opening systems top the list of technologies they plan to make new or replacement decisions for. But for many, their 2023 plans to make new or replacement decisions were not realized (Table K and Table L). This was a common theme for 2023, with actual deployment falling short of plans for commercial DAO and mobile banking, P2P payments and CRM (for credit unions specifically).

Table K: Banks' New System Selections/Replacements

	Will select new or replacement app in 2024	Selected new or replacement app in 2023	Planned to select new/replacement app in 2023
Consumer digital account opening	27%	19%	29%
Commercial/small business online banking platform	19%	8%	13%
Customer relationship management	19%	16%	15%
Fraud/BSA/AML	19%	12%	15%
Commercial/small business DAO	18%	11%	23%
Data analysis/business intelligence	18%	10%	12%
Commercial/small business digital loan origination system	15%	20%	13%
Commercial/small business mobile banking platform	14%	5%	24%
Consumer mobile banking platform	14%	10%	13%
Consumer online banking platform	14%	10%	14%
Consumer digital loan origination system	13%	17%	28%
Payments hub	13%	5%	7%
Person-to-person payments	11%	9%	14%
Marketing automation	10%	10%	12%
Online bill payment	10%	6%	8%
Enterprise risk management	9%	6%	3%
Call center system	8%	12%	13%
Core integration/middleware platform	8%	5%	8%
Credit card processing	8%	4%	7%
Mobile bill payment	8%	4%	7%
ATM processing	5%	3%	6%
Card self-service	5%	5%	7%
Core processing system	5%	8%	7%
Document imaging/workflow	5%	5%	8%
Debit card processing	4%	4%	10%
Interactive teller system	3%	4%	7%

Source: Cornerstone Advisors surveys of bank and credit union senior executives, 2022 to 2024

Table L: Credit Unions' New System Selections/Replacements

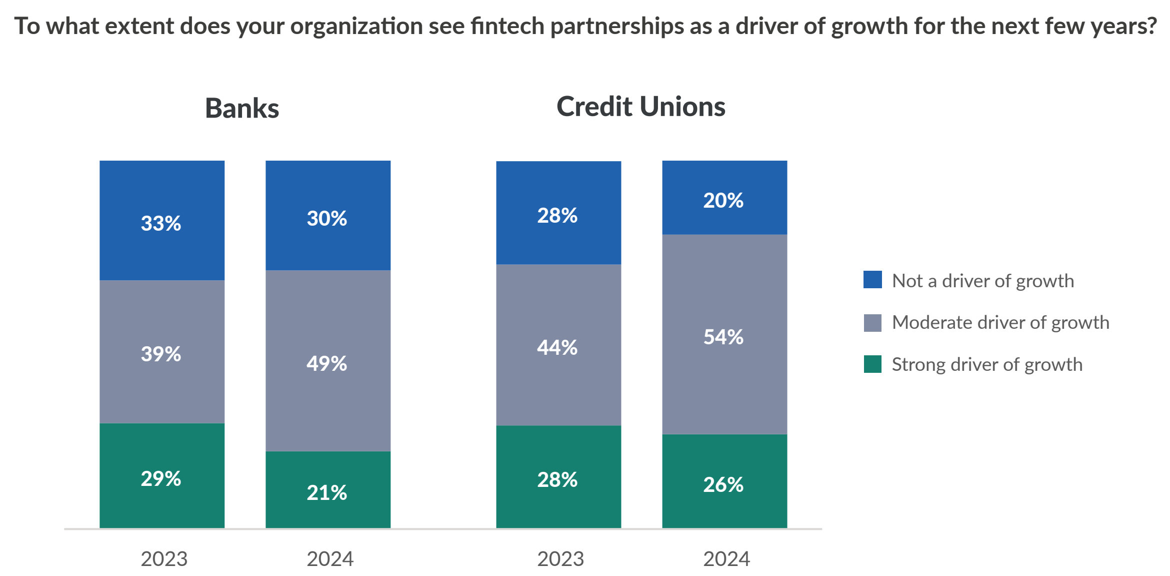
	Will select new or replacement app in 2024	Selected new or replacement app in 2023	Planned to select new/replacement app in 2023
Consumer digital account opening	36%	12%	32%
Call center system	23%	21%	21%
Payments hub	18%	5%	10%
Fraud/BSA/AML	16%	9%	5%
Customer relationship management	15%	9%	28%
Person-to-person (P2P) payments	15%	16%	26%
Consumer digital loan origination system	14%	10%	21%
Marketing automation	13%	11%	13%
Commercial/small business DAO	12%	3%	10%
Consumer online banking platform	10%	14%	16%
Card self-service	9%	5%	10%
Commercial/small business mobile banking platform	9%	5%	14%
Debit card processing	9%	5%	9%
ATM processing	9%	5%	4%
Commercial/small business online banking platform	9%	6%	14%
Credit card processing	9%	9%	11%
Data analysis/business intelligence	9%	11%	15%
Consumer mobile banking platform	8%	15%	12%
Commercial/small business digital loan origination system	7%	6%	12%
Core processing system	7%	3%	4%
Enterprise risk management	7%	8%	9%
Mobile bill payment	6%	9%	6%
Online bill payment	6%	9%	11%
Core integration/middleware platform	5%	7%	6%
Document imaging/workflow	5%	4%	8%
Interactive teller system	5%	8%	10%

Source: Cornerstone Advisors surveys of bank and credit union senior executives, 2022 to 2024

Just the Two of Us, We Can Make it if We Try

Fintech partnerships have been a concern for bankers over the past few years, and 2024 won't be any different. That said, the survey data suggests that the bloom may be coming off the rose. The percentage of banks and credit unions that say fintech partnerships are a strong driver of growth dropped between 2023 and 2024. Those who consider partnerships to be a moderate driver of growth picked up the slack, however. The percentage of banks that see partnerships as a growth driver—strong or moderate—grew from 68% to 70%. Among credit unions, the percentage rose from 72% to 80% (Figure 21).

Figure 21: Fintech Partnerships as a Driver of Growth



Source: Cornerstone Advisors survey of 359 community-based financial institution executives, Q4 2023 and Q1 2024

Financial institutions' partnership objectives are shifting. In 2024, creating new products/services, increasing deposit account volume, and reducing operational expense will be important objectives to a higher percentage of banks in 2024 than they were in 2023. This doesn't surprise us, as these objectives align with banks' broader strategic goals and concerns. The drop in the importance of improving loan productivity was a surprise, however (Table M).

Table M: Banks' Fintech Partnership Objectives

What are your bank's three most important objectives for fintech partnerships?

	2023	2024
Create new products/services	39%	47%
Increase deposit account volume	36%	46%
Reduce operational expenses	34%	43%
Improve deposit account opening productivity	43%	42%
Reduce fraud losses	24%	34%
Increase noninterest income	26%	32%
Improve loan productivity	45%	26%
Increase loan volume	31%	24%
Expand geographic footprint	13%	14%

Cornerstone Advisors survey of community-based financial institution executives, 2022 to 2024

Fintech partnership objectives are changing for credit unions, as well. Between 2023 and 2024, the percentage of credit unions that cited reducing fraud losses as an important objective leaped from 28% to 42%, making it virtually as important as any other objective (Table N).

Table N: Credit Unions' Fintech Partnership Objectives

What are your credit union's three most important objectives for fintech partnerships?

	2023	2024
Improve deposit account opening productivity	34%	44%
Increase loan volume	58%	43%
Reduce fraud losses	28%	42%
Create new products/services	33%	36%
Reduce operational expenses	31%	34%
Improve loan productivity	33%	31%
Increase deposit account volume	27%	26%
Increase noninterest income	19%	18%
Expand geographic footprint	21%	13%

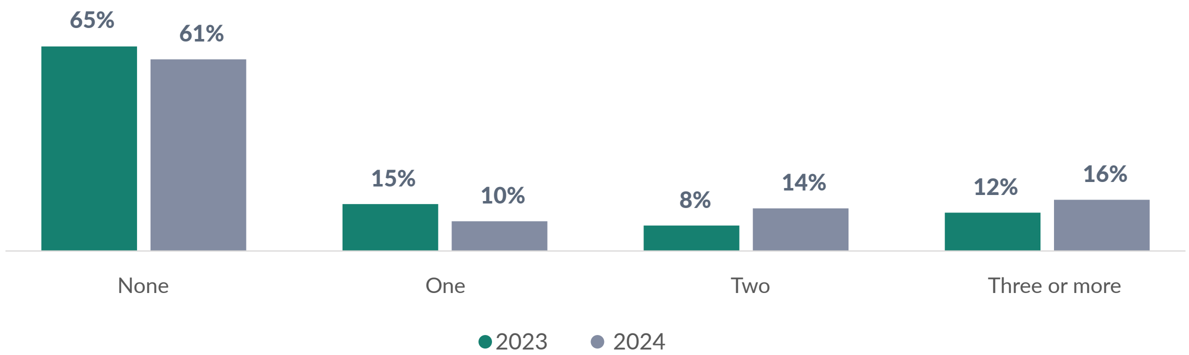
Cornerstone Advisors survey of community-based financial institution executives, 2022 to 2024

’Cause I’m a VC, I’m a VC

Financial institutions aren’t simply partnering with fintechs—they’re investing in them. Banks and credit unions have become the new venture capitalists. Among banks that see fintech partnerships as a driver of growth, roughly 4 in 10 plan to invest in fintechs in 2024, up from 35% in 2023. Three in 10 will invest in two or more fintechs, up from 20% in 2023 (Figure 22). Among credit unions who see fintech partnerships as a driver of growth, nearly half expect to invest in fintechs in 2024, and nearly 3 in 10 will invest in two or more fintechs (Figure 23).

Figure 22: Banks’ Investment Activity in Fintech Startups

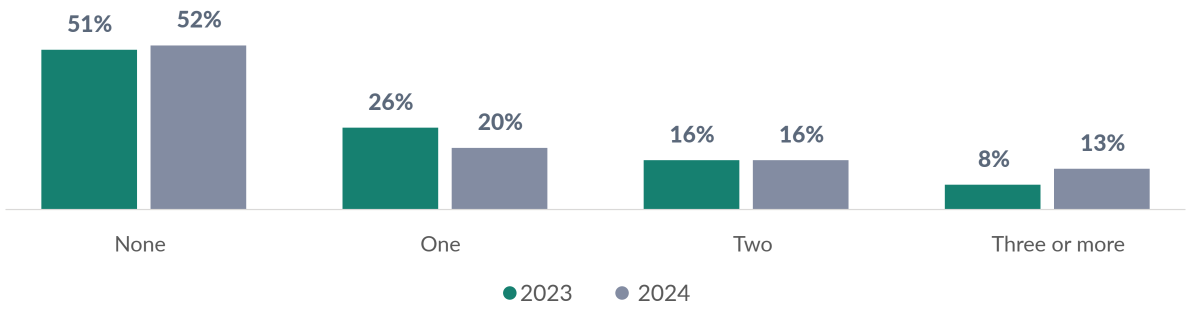
How many fintech startups did your bank invest in in 2023, and how many fintech startups do you think it will invest in in 2024?
(Base=Banks that see fintech partnerships as a driver of growth)



Source: Cornerstone Advisors survey of 359 community-based financial institution executives, 2023 to 2024

Figure 23: Credit Unions’ Investment Activity in Fintech Startups

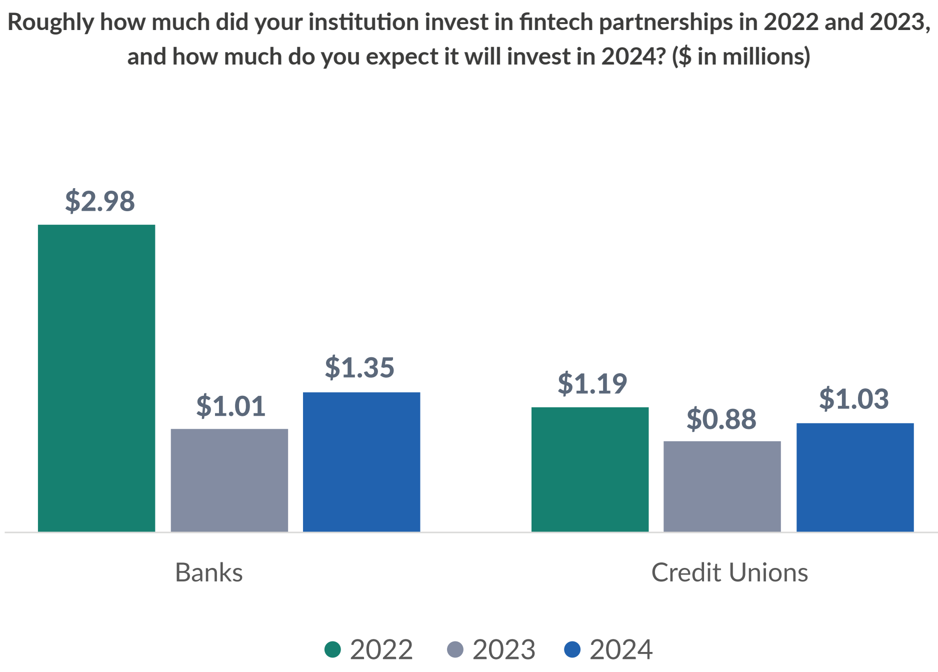
How many fintech startups did your credit union invest in in 2023, and how many fintech startups do you think it will invest in in 2024?
(Base=Credit unions that see fintech partnerships as a driver of growth)



Source: Cornerstone Advisors survey of 359 community-based financial institution executives, 2023 to 2024

When we surveyed banks at the end of 2022 about their 2023 plans, those investing in fintechs projected that their investment levels would increase to an average of nearly $4 million per bank. That didn't happen. Average investment per bank dropped to barely over $1 million. Both banks and credit unions are more optimistic about their investment opportunities for 2024, however (Figure 24).

Figure 24: Financial Institutions' Investments in Fintech Startups



Source: Cornerstone Advisors survey of community-based financial institution executives, 2022 to 2024

Banks and credit unions increasingly see the fruits of their partnership labor. Among credit unions, roughly 30% say that their loan volume and productivity has improved by 5% or more from partnering with fintechs. Among banks, that percentage is much lower (Table O). Why the difference? Our take is that fintechs are helping credit unions get into lending spaces where the credit unions had little presence, making a 5% improvement much easier.

Table O: Fintech Partnership Impact

Percentage of financial institutions that say fintech partnerships have had a "significant" impact (i.e., >5% improvement) on the following business metrics

	Banks		Credit Unions	
	2023	2024	2023	2024
Loan productivity	15%	15%	20%	30%
Loan volume	15%	10%	25%	29%
Deposit account opening productivity	12%	15%	9%	13%
Customer/member retention	10%	10%	4%	8%
Deposit account volume	11%	14%	4%	7%
Payments-related revenue	7%	11%	1%	5%
Other noninterest income	7%	8%	1%	5%
Operational expenses	7%	11%	6%	4%
Products per customer	3%	7%	2%	3%

Source: Cornerstone Advisors surveys of bank and credit union senior executives, 2022 to 2024

What's Going On (With Core Systems)?

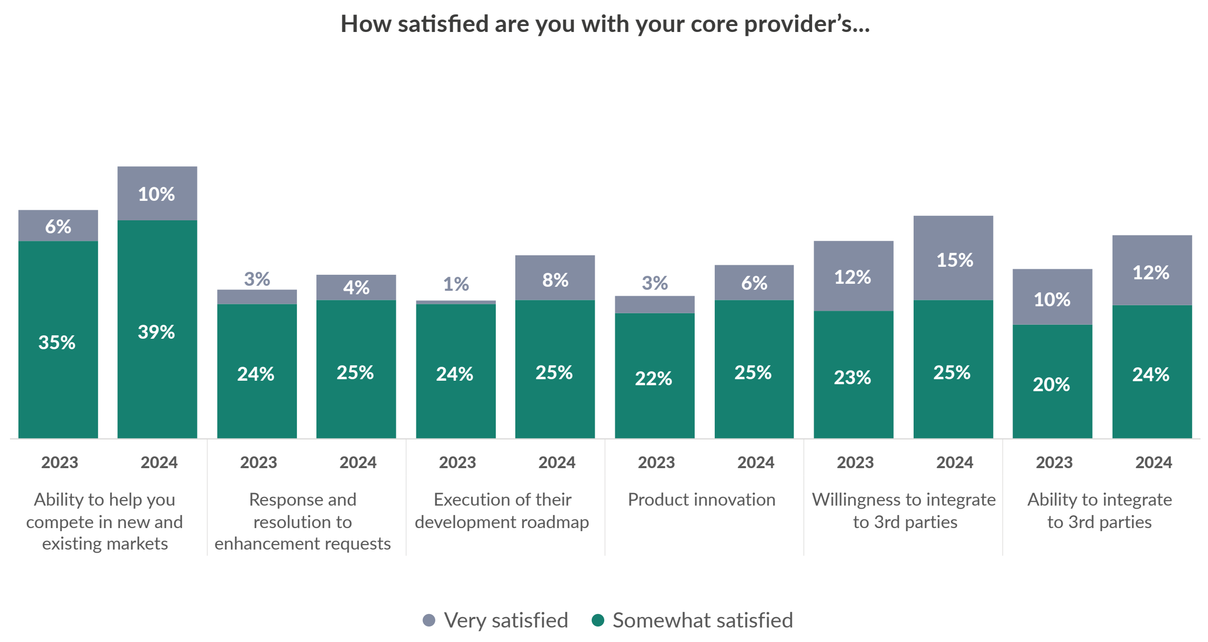
Mother, mother, mother, there's too many of you sighing, "Our core is not the answer, to make it work we're sick of trying. You know we've got to find a way to avoid those repercussions here today."

OK, I'll stick to report writing. Complaining about tech vendors is one of bankers' favorite pasttimes, but we do believe it's helpful to provide those technology companies with perspective on what their clients think about them. This year's findings may be surprising to a few people.

Among bank respondents, the percentage of executives who are somewhat or very satisfied with their core vendors' abilities grew in 2024 from the prior year. You could point out that the satisfaction levels are still well below where they should be, and that would be a point well taken. But the numbers are moving in the right direction.

Some of the areas that saw the bigger shifts included: 1) ability to help compete, where the combined satisfaction score grew from 41% to 49%; 2) execution of the development roadmap, which increased from 25% to 33%; and 3) ability to integrate third parties, which improved from 30% satisfied to 36% satisfied (Figure 25).

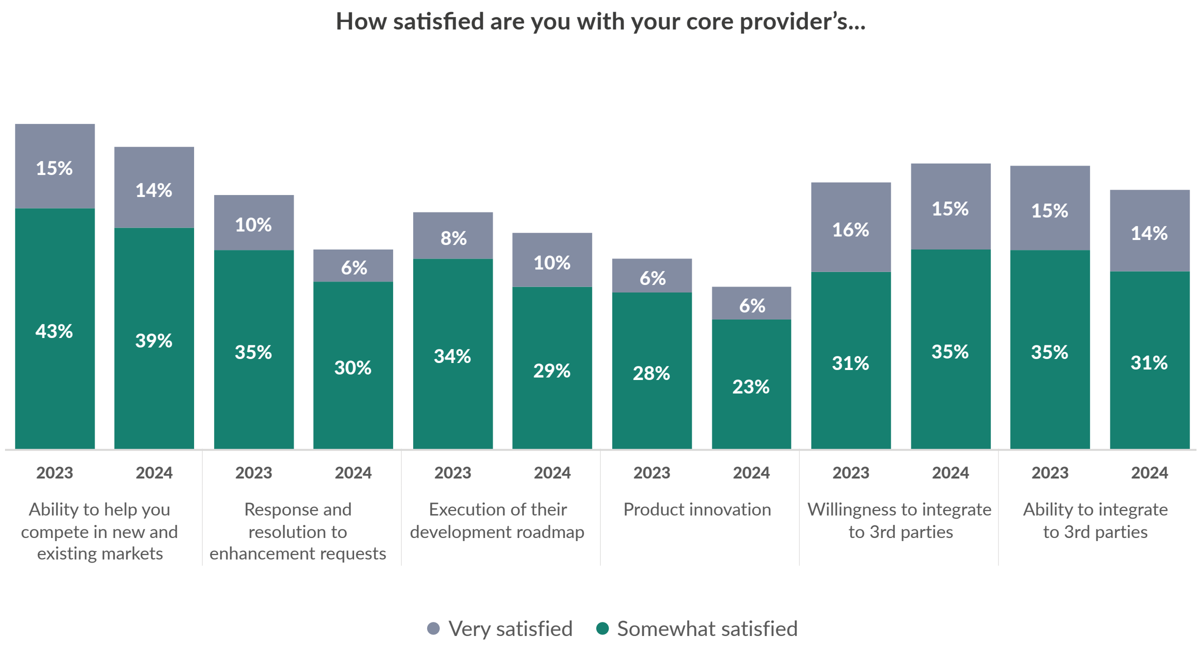
Figure 25: Banks' Satisfaction with Core Providers



Source: Cornerstone Advisors survey of community-based financial institution executives, Q4 2022 to Q1 2024

In contrast, credit union execs took their evaluations of their core providers down a notch from 2023. Across all but one of the attributes we asked about, fewer credit union respondents expressed satisfaction with their core provider in 2024 than they did in 2023. The biggest decline was for core providers' response and resolution to enhancement requests (Figure 26).

Figure 26: Credit Unions' Satisfaction with Core Providers



Source: Cornerstone Advisors survey of community-based financial institution executives, Q4 2022 to Q1 2024

As one credit union executive said:

> "For smaller financial institutions, fintech providers like Fiserv, FIS and Jack Henry will never be able to provide all the customization an FI wants. These institutions get stuck leveraging whatever features their core provider gives them. The alternative is to develop and create their own or use APIs. Paying for the talent to develop and manage these systems makes it very difficult for a smaller FI to thrive, however. Whenever a core provider buys some smaller company, that's one less competitor in the field of too few competitors. It's frustrating."

In fairness to the core providers, credit union executives' level of satisfaction is still higher than the bankers', but it's moving in the wrong direction.

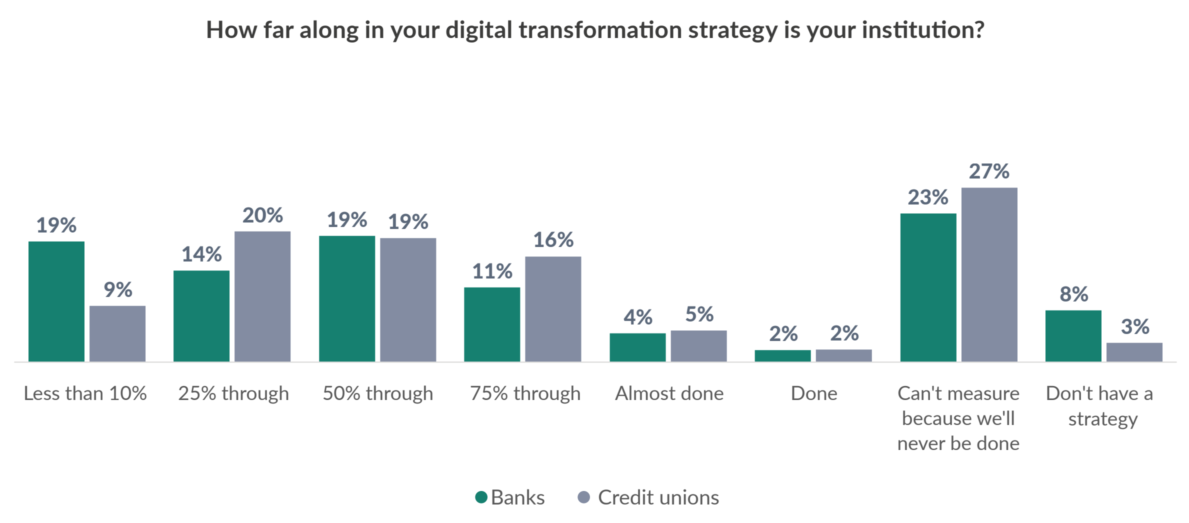
No, I Would Not Give You False Hope

Previous years' editions of this report have contained meaty sections on the topic of digital transformation. Not this one. Why? Because: 1) the term "digital transformation" has come to mean too many different things to different people and organizations; 2) if you haven't figured out your digital transformation strategy by now, is anything I say here going to help you? and 3) as a management fad, digital transformation is at the end of its life cycle. As one exec told us:

> "Digital transformation has been a buzz term in our industry for many years. That term provides false hope that financial institutions will get to an endpoint and 'transform.' If we want to succeed in this fast-paced changing market, we need to shift our thinking towards *evolution*. We will always continue to evolve our digital offerings to meet member and organizational needs. If we don't, we will be left in the dust."
>
> —Brian Alfano, Chief Digital Officer, OCCU

Spot on, Brian. In previous years, we've asked financial institutions how far along they are in their digital transformation. Until this year, we never gave them the option to say "can't measure, because we'll never be done." The 23% of banks and 27% of credit unions that said they'll never be done with their digital transformation strategy are the ones with their heads screwed on straight (Figure 27). Feel free to flame me for that comment.

Figure 27: Digital Transformation Progress



Source: Cornerstone Advisors survey of 359 community-based financial institution executives, Q4 2023 and Q1 2024

Get It Off Your Chest, Get It Off My Desk

No report that looks back at 2023 would be complete without a reference to Taylor Swift!

As we did in previous years, we asked this year's survey respondents if there was anything they wanted to "get off their chests." The following comments didn't fit anywhere else in the report, but were worth including:

> "Trade associations need to get much better about countering merchant narrative about interchange. We all know lowering or capping all interchange will make banking products more expensive, and merchants won't lower their prices. Why aren't they shouting this to consumers?"

My take: Could not agree more. As I wrote on my blog (shameless plug for my Fintech Snark Tank blog on Forbes): "It's hard to believe that proponents of the new regulations—on both sides of the aisle—can't see second-order effects (i.e., unintended consequences) of the proposed rules." Specifically, I was referring to an impending credit crisis, tax shortfalls, an explosion in fraud and negative impacts on financial inclusion.

> "Very concerned about the core providers and third-party consultants having sufficient resources to convert all the acquisitions that are coming. We're seeing run-off in the core provider's experienced staffers (retirements). Similar concerns about technical support from just about any company. We expect service levels to decline."

My take: Agreed. This is, however, an industry-wide issue, not just a problem for tech companies and consultants. As I mentioned earlier in the report—you haven't forgotten already, have you?—I was surprised by the decline in the percentage of executives mentioning the ability to attract talent as a top concern. My interpretation was not that it's getting easier to find and attract talent but that hiring plans have slowed down. That's a cyclical thing, though. What kind of talent acquisition shape will the industry be in when the cycle turns up?

> "With the finalization of the open banking rule by the CFPB, it has put financial institutions that have historically served Main Street in a precarious position. What isn't being openly discussed is how dramatically this will impact the stability of regional and community-based financial institutions and their balance sheets. Realistically, how do FIs meet their regulatory requirements around capital and liquidity, which is directly tied to their ability to effectively lend, if the deposit marketplace becomes even more inherently liquid than it already is? Unless there is a leveling of the playing field between fintechs and traditional FIs from a regulatory perspective, and material shifts in the way this industry functions, I don't see how this isn't destabilizing for the industry as a whole."
>
> —Jack Ingram, CIO, Whatcom Educational Credit Union

My take: This is the elephant on the open banking table.

> “Small credit unions are some of the strongest financial institutions and do not need to merge in order to be competitive!”
>
> —Steve Bowles, CEO , SRI Federal Credit Union

My take: Bowles’ comment applies to pretty much any institution in the industry. Technology is the key to creating scale and playing bigger than you are.

> “Ever since I have joined this industry, there is always some impending doom... That’s the nature of the business. So rather than flounder and complain, we need to develop a backbone and be willing to pivot.”

My take: The lady (or man) doth protest too much, methinks. There are lots of leaders in community-based financial insitutions with a strong backbone doing a great job of pivoting.

> “Organizations are heavily focused on changing the experience and making the necessary changes to get there. We continue to hear organizations that are wanting to find new ways to add value and to modernize/revolutionize their services. There are still significant challenges and laggards in the industry, but the awareness is finally there that we must compete at a consumer need level instead of only the words of ‘people helping people.’ When your solutions are obsolete, you aren’t actually helping.”
>
> —Jeff Pascoe, Chief Data and Digital Officer, Vibe Credit Union

My take: I can just say “I agree,” right?

> “As an industry, we are scared of AI—we need to get in front of it in order to control it. Our creative and powerful use of AI is a key driver of our ability to elevate credit unions to a new level of service growth.”
>
> —Jeffrey Staw, Chief Innovation Officer, Open Technology Solutions

My take: No disagreement with the comment, but we need to stop using the term “AI” indiscriminately. There are a number of different AI technologies (see the AI section earlier in the report). Some of them have been in use for years, while newer ones, like generative AI, are only first being used within financial institutions. As a senior executive in a financial institution, you risk confusing your staff (and customers/members) if you’re not specific about what you mean when you talk about “AI.”

> “This survey took longer than 10 minutes.”

My take: Uh, yeah, sorry about that. But thanks for taking the survey, anyway.

Paradise Waits on the Crest of a Wave

Closing time, one last call for alcohol, so finish your whiskey or beer.

Before concluding with some of our own thoughts for what 2024 might hold, I want to go back and remind you of the theme of this report: Finding the next wave to ride.

The idea behind that is that—let me know if I'm the first consultant to tell you this—the industry is undergoing changes. I'll refrain from using adjectives like "transformational" or "earth-shattering" when referring to those changes. Adapting to the changes can be a difficult process for a lot of organizations.

The ones who succeed, the ones who deal with the changes most effectively, are those that have a "true north"—a strategic vision and destination to help them prioritize their efforts and stay on track. Doing that means finding a wave—which could be a key service like real-time payments that generates new revenue streams and new customers, or a niche strategy that defines a new customer or member segment to build new growth on, or using generative AI to create new step-function levels of productivity improvement (i.e., speed).

As the Grateful Dead once said, "Paradise waits on the crest of a wave."

I Can See Clearly Now

To close, here are my predictions for 2024:

1. A big(ger) bank will acquire a BaaS bank.

The percentage of banks looking to get into the banking as a service (BaaS) space is down from previous years. Big surprise, eh? Regulatory headwinds, iffy economic conditions and a more conservative approach to tech innovation spending are combining to put a damper on BaaS growth.

The drop in interest in BaaS doesn't change the fundamental underlying demand for BaaS services, however. Fintechs have an increasing appetite for new products, better tech integration and diligent compliance.

That adds up to opportunity for larger banks (>$100 billion in assets) to get into the space more aggressively.

Prediction: A $100+ billion bank will acquire a smaller BaaS-focused bank in 2024 to accelerate its entry into the BaaS market and then bolster that acquisition by adding a healthy dose of technology, compliance and business development resources to the BaaS bank.

Over the next couple of years, we'll see more of these acquisitions as larger banks take over the BaaS space.

2. Bank-offered BNPL will grow significantly.

In past years, this report has asked financial institutions about their plans to offer buy now, pay later (BNPL). The response has been tepid, at best. Consumer interest and activity in BNPL—with the threat, if not reality, of lower interchange revenue—is becoming too much for banks to ignore in 2024. As Nandan Sheth, CEO of fintech Splitit, wrote in Forbes:

> "Banks have not moved fast to address the consumer demand for pay later solutions embedded within the merchant purchase journey. Banks miss the critical 'in-checkout' moment, ceding ground to fintechs with integrated installment plans."

Sheth believes that banks have advantages in terms of scale, trust and available credit. According to Sheth, "The key to triumph in the ongoing contest for the future of BNPL lies in synergizing the strengths of banks to offer a distinctive set of differentiators through strategic partnerships."

I agree.

And when I say "bank-offered" BNPL will grow significantly, it will (and should) be credit unions leading the way. Tech companies that enable banks and credit unions to provide BNPL will have a good year in 2024.

Financial institutions that offer BNPL, however, will struggle to see significant volume. Why? Because BNPL is as much a prepayment part of the purchase process as it is a payment decision.

Firms like Klarna (don't call them a BNPL company) understand this and offer tools and technologies to their merchant partners to help them influence consumers' choice of product and provider—not just their payment mechanism.

3. The "employee experience" will be an area of focus.

C'mon, you've got to be at least half as tired of hearing about the "customer experience" as I am. For more than 15 years, self-proclaimed "customer experienceists" (or whatever they call themselves) have asserted how important CX is, how it's the key to differentiation, blah, blah, blah.

It's time for a change of focus. With a renewed focus on efficiency—coupled with sure-to-come layoffs in the banking industry—smart bankers (and tech companies) will realize that the "employee experience" is the new way to realize productivity gains and buoy employee satisfaction.

One enabler of the new and improved employee experience: the continued deployment of chatbots that are often more effective at helping employees get their work done than they are at helping customers get their questions answered.

4. Real-time payments volume won't materialize in 2024.

For sure, the number of banks signing up with FedNow will continue to grow, and the percentage growth of real-time payments volume will be high—because it's easy to produce a high growth rate on small volume. As a percentage of all payments, however, RTP won't make a dent. Two things will hold down RTP volume in 2024:

1. **Receive-only dominates.** Most of the banks that have signed up for RTP through FedNow are in receive-only mode. As a friend joked on LinkedIn recently, "Everyone has a mailbox but no one is sending mail."

2. **Lack of an RTP "solution."** Tony Hayes, founder of the Banking & Payments Group, recently pointed out that "if priced correctly, real-time payments could boost forward-thinking banks' income." "If priced correctly" is a big if, however. Pricing—particularly for fee-based services—is hardly a strong point for many financial institutions.

At a recent payments conference, a number of bankers referred to FedNow as a "solution." This is a misconception. Better to think of FedNow as a "capability." You don't price—and sell—capabilities. You package capabilities into a solution—a "product" or "service offering"—then determine what pricing options are most attractive to your target market and market the solution to them. It will take some time and effort for banks to get this right.

By the end of 2025, however, commercial RTP payments will start to grow more significantly, as smart banks realize that's where the opportunity (i.e., money) is.

5. Generative AI use will be under- and overstated.

No list of predictions for 2024 would be complete without some mention of artificial intelligence, right?

Except for a handful of larger banks with innovation teams focused on the use of gen AI tools, most midsize and small banks and credit unions won't do much with generative AI in 2024. More accurately: They won't know that they're doing something with it.

What I mean by that last comment is that, when you ask senior bank execs what their institution is doing with generative AI, many say "nothing right now" or "we're exploring opportunities" (yeah, right). They say that because they have no clue that marketing is using gen AI tools to write marketing copy or that legal is using it to construct and review contracts. You know that really eloquent blog post the 22-year-old intern wrote? ChatGPT.

On the flip side of the equation, there will be (and are) bankers who think their institution is experimenting with generative AI when what they're really using is conversational AI and machine learning.

Bonus prediction: Confusion surrounding the various types of AI technologies won't clear up in 2024.

Have a great 2024. Got any thoughts or comments about the report you'd like to share? Don't hesitate to share them with me at rshevlin@crnrstone.com or on LinkedIn at www.linkedin.com/in/ronshevlin.

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As Cornerstone Advisors' chief research officer, Ron Shevlin heads up the firm's fintech research efforts and authors many of the firm's studies. He has been a management consultant for more than 30 years, working with leading financial services, consumer products, retail and manufacturing firms worldwide. Prior to joining Cornerstone, Shevlin was a researcher and consultant for Aite Group, Forrester Research and KPMG. Author of the Fintech Snark Tank blog on Forbes, Shevlin is ranked among the top fintech influencers globally and is a frequent keynote speaker at banking and fintech industry events.

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About Cornerstone Advisors

After 20 years in this business, Cornerstone Advisors knows the financial services industry inside and out. We know that when banks and credit unions improve their strategies, technologies and operations, improved financial performance naturally follows. Because we live by the philosophy that you can't improve what you don't measure, we show banks and credit unions how to use laser-focused measurement to develop more meaningful business strategies, make smarter technology decisions and strategically reengineer critical processes.

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