Next in banking and capital markets 2024:

Turn uncertainty into opportunity

pwc

Overview

Leadership is tested in adversity, and there's no shortage of that in today's difficult banking environment. Performance is under pressure from both external forces and internal complexity that compounds challenges. It's becoming clear that if banks simultaneously want to improve financial performance, harness technology and seize growth opportunities they will need a different operating model.

The current uncertainty is a time to focus on two things: defining what sets your bank apart and simplifying your operations in support of your unique advantages.

A key to competing effectively for clients is optimizing financial performance across three intertwined issues: balance sheet management, technology and regulatory response. Leaders will want to be more deliberate in deciding where to allocate capital and liquidity and prioritize investments to solve technology and regulatory issues.

With a strategic view on how the interplay of these issues drive opportunities and challenges facing their institution, banking leaders can define a simpler operational configuration to enable their vision. Complicated workarounds and one-off solutions are too costly to sustain in terms of both agility and expense.

Transformational change to a bank's operating model can be complex and costly so leaders need to take a comprehensive approach to evaluate and optimize business mix, balance sheet strategy, legal entity structures, deal and partnership opportunities and an often overlooked source of funds to finance change: tax strategy. The right structures that tap into the most beneficial part of the tax code for your circumstances can free up capital that's needed to accelerate reinvention.

Overcome adversity by focusing on what you can control: Define what differentiates you and pursue operational simplification in support of your vision. Taking those steps is the bedrock on which to transform your firm for a brighter future.

Webcast series: Join us for discussions on what's next in banking and capital markets 2024.

Pivotal trends in 2024 will fall into these categories:

- **Anticipate regulatory action**
- **Deliver financial performance**
- **Accelerate technology transitions**
- **Embrace responsible GenAI**
- **Address climate transition**

Anticipate regulatory action

Being on the back foot and reacting to regulators' demands since last year's bank failures is costly and resource consuming. Additionally, it's preventing risk teams from getting ahead of the evolving complexity in how regulations are interpreted and applied.

Executives can seize on today's cost pressures to do away with disconnected governance and controls systems and manual processes residing in different departments. Streamlining the data and technology ecosystem that feeds risk and control decisions can lower costs and free up valuable talent to handle more complex tasks. Implementing upgraded compliance infrastructure can help instill regulatory confidence.

There's a further step to consider: speed up modernization by automating with GenAI. For example, the necessary, yet tedious, work of compiling regulatory inventories is a task GenAI is already accomplishing. We've witnessed cost reductions associated with regulatory inventories — which cover thousands of rules, laws and regulations and the implemented compliance actions and controls — of 50% or more. Your skilled employees then have more time to use their capabilities on higher value activities.

Lower costs, better compliance management and more valuable employees — that's a rare win-win-win situation.

16%

Estimated aggregated increase in common equity Tier 1 capital requirements under Basel III Endgame proposal for US banks with over $100 billion in total assets

Source: S&P Capital IQ

Risk and regulations: It's strategic now

CRO:

What keeps old systems and manual processes in place? More often than not, it's inertia. If a risk process works and hasn't caused problems, many leaders likely don't see an urgent business case for change. However, complacency raises the odds that regulators will force radical changes in risk processes when outside events indicate a potential weakness. Proactive remediation is typically less expensive and provides more strategic business value than the alternative.

CEO/Board:

More and more CEOs and directors are integrating their growth discussion with regulatory strategy. Higher regulatory hurdles in banking are prompting board members and CEOs to ask in the planning stage how, for example, upcoming Basel III capital rules are going to be implemented in a particular country. Leaving important compliance decisions to the business lines could negatively impact ROI, slow the bank's expansion and raise questions among stakeholders about the future value of the strategy.

Learn more:

- Our Take
- Basel III Engame: The next generation of risk-weighted assets
- Managing generative AI risks
- Risk Link, a PwC Product
- Financial Services Risk and Regulatory

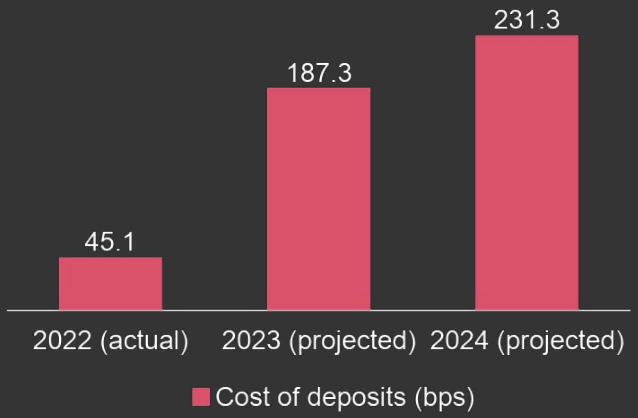
Deliver financial performance

There's a universal message for bankers from last year's tsunami of changes: different profitability levers have to be found. Making changes and trimming costs around the edges is not an effective response to today's novel business conditions of high interest rates, constrained funding, economic uncertainty and regulatory pressure.

Moving the needle on profitability likely means greater fiscal discipline across business lines, where the bottom-line takes priority over balance sheet growth. To do that, identify core clients and businesses and winnow ancillary activities. Reallocating capital to your highest conviction areas can provide the capacity to invest in sustained technology and talent development necessary to create the differentiated, digitally enabled experiences that have the power to attract and acquire new customers and deepen relationships.

The search for different profitability levers should entail a data-driven approach to analyzing risk-adjusted financial performance and may involve new partnerships or nonbank relationships that can help optimize returns and maximize the "why bank with us" narrative. Levers should also include considerations for risk, regulatory implications, accounting and tax strategy as these are critical and sometimes under-estimated components of financial performance and deal value.

Deposit costs will continue to rise even as the Fed pauses rate hikes



Source: S&P Capital IQ

Learn more

- **Deals Outlook 2024: Banking and capital markets**

Accelerate technology transitions

Technology – it's a source of hope and frustration. Modern cores, digitized operations and cloud-based computing remain promising sources of renewal and reinvention for banking's business model. However, grafting new systems onto existing ones continues to hamper the return on technology spending and delay time to benefit. And that's before adding GenAI into the picture.

Under today's conditions, deciding when, how and what systems to upgrade takes on higher strategic significance and likely requires the input of the entire C-suite. Their perspective is important because your modernization plan may shift as you pull on new profitability levers amid changing regulations and increasing costs.

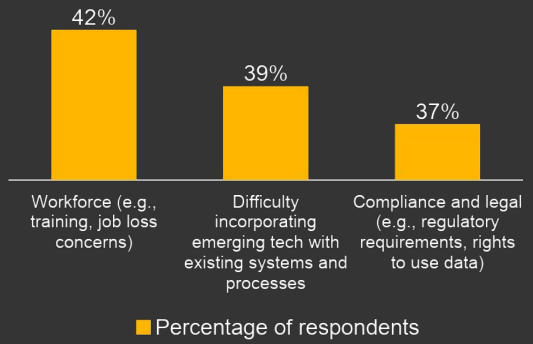
While different lines of business may have different needs, that does not mean they need different technological backbones. Increasingly, the industry cloud for banking is handling end-to-end tasks, including running a modern core in parallel with legacy systems, which provides the benefits of cloud computing and centralized regulatory compliance controls without having to resort to risky and expensive rip-and-replace approaches.

Developer-less, cloud-based products

CIO/CTO:

Time to market with new products is more critical with the intense focus on profitability. A cloud intelligence layer, with its visual user interface, makes it possible for developer-less product creation and updating. Essential changes that boost success can happen in just a few hours, not the weeks that it would take in the not-too-distant past. And since this is cloud-based computing, risk and controls can be applied with a few clicks of a mouse.

Workers, systems integration and compliance: The three main challenges banking and capital markets firms face when adopting emerging technology



Source: S&P Capital IQ

Learn more:

- Cloud-powered banking is live and producing enormous value
- Payments modernization in the age of acceleration
- Digital and cloud transformation for banking
- Industry Cloud for Banking

Embrace responsible GenAI

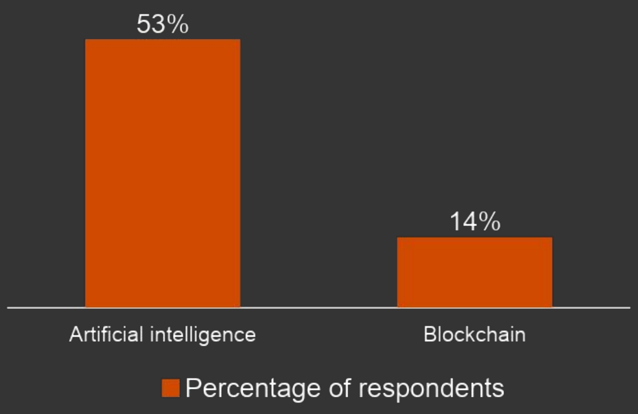
Adoption of GenAI in banking is deliberate and careful, and for good reason. As a highly regulated industry in possession of sensitive data, banks must add GenAI model governance to their current AI governance practices, employ data ring fencing and put compliance and reporting at the forefront. Those steps may require capital, but efficiency savings from across the firm can more than offset the cost.

Our rough estimate is that a bank's cost structure could improve by approximately 20%-30% by using GenAI to automate roughly 20% of a worker's day. Furthermore, AI enables banks to deepen engagement with existing clients by improving experience through mass personalization, leading to increased retention, cross-selling and upselling opportunities. Early estimates suggest a 1.5-2x lift in upsell and cross-sell potential.

To help capture those valuable improvements, executives need to be closely involved in the design of AI governance and processes with the goal of guiding the organization through change. And to avoid AI becoming siloed in one area of the business, link the technology to strategy and broader enterprise-wide transformation efforts.

Accelerating AI-driven transformation is more easily achieved by taking what we call a crawl, walk, run approach to adoption. Centralizing the responsibility for adoption under an executive who reports to the CEO helps to: determine the security foundations and use cases that can be broadly applied to the business (crawl); establish an AI factory and operationalize governance (walk); and scale up the AI factory to create "use-case families" (run). Through centralization and scale, banks can take the lead and derive maximum benefit from AI and GenAI. And, critically, executives must use their oversight powers to **manage regulatory risk** from AI, for instance in terms of bias in credit decisions.

No contest: AI trounces blockchain as the top emerging tech priority for banking and capital markets firms



Q: Where is your company prioritizing emerging technology investment? (ranked top only, base 59)
Source: PwC Emerging Tech Survey 2023

Address climate transition

A new direction has been set. At the COP 28 summit, dozens of countries agreed to accelerate the adoption of renewable energy and reduce fossil fuel use. Banks stand at the center of catalyzing the energy transition with trillions of dollars backing a multitude of sustainable finance objectives and projects. The banking system will be a key enabler of national efforts to achieve climate objectives while supporting economic growth.

To capitalize on the energy transition, banks need to integrate climate and sustainability into how they evaluate risk and opportunity in every financial product and service, create an integrated sustainability roadmap, a credible transition plan and develop strategically informed investor-grade reporting.

A climate transition plan serves as a powerful mechanism to prioritize, inform and take action in support of your bank's business and climate objectives. By beginning the transition planning process now, you can strengthen climate risk management capabilities, better position your business to capitalize on market opportunities and craft a compelling roadmap detailing your firm's role in shaping a sustainable future.

$125 trillion

Estimated total investment needed to reach net zero emissions by 2050

Source: United Nation Race to Zero campaign

Learn more

- Climate transition planning for financial institutions
- Bank boards and ESG: Accelerating the pace of change

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