EXECUTIVE REPORT: 2016 BANKING PRIORITIES STUDY

Introduction

Each year, CSI surveys banking executives from across the country to find out what they foresee as their greatest challenges, top opportunities and foremost concerns for the year ahead, as well as how they plan to use technology and investments to rise to the occasion. In conducting this annual Banking Priorities Study, we deliver peer-to-peer insight that can help financial institutions in planning and strengthening their own strategies, or simply verifying where they stand in relation to the rest of the industry.

This executive report analyzes the survey feedback on 11 questions asked of more than 100 banking executives, who represent institutions of various asset sizes and geographic locations. Detailed demographic information is provided at the end of this report.

Executive Summary

Based on their responses, financial institution executives seem to hold the general opinion that economic conditions will continue to improve in 2016. The reasoning for this outlook takes a decidedly unique turn this year, given that the U.S. Federal Reserve just raised interest rates for the first time since 2006. Although this survey was conducted in November, most in the financial industry considered the rate hike a done deal well before it was solidified on Dec. 16, 2015.

The Fed's move indicates its confidence that current economic conditions are strong enough for the environment to sustain the shock of a long-coming rate hike. And according to survey responses, it appears financial institutions agree. For instance, the largest percentage of respondents cited that driving interest income and loan growth is their greatest opportunity heading into 2016.

Below are highlights from the 2016 Banking Priorities Study:

- Boosting interest income/loan growth remained the top opportunity for financial institutions, with the percentage (31.3%) unchanged from 2015.

- Gaining steam this year as a major opportunity is enhancing mobile/omnichannel banking at 11.1%, up from 3.2% last year.

- Community financial institutions again plan to differentiate themselves through excellent customer service as their main tactic for attracting new deposit customers.

- Regarding institutions' outlook on 2016 lending growth, the percentage expecting to increase lending this year dropped slightly to 69.4% from last year's 73.1%.

- The top three areas for which institutions plan to increase spending over the next 12 months are information technology, EMV implementation and regulatory compliance.

- EMV implementation, customer relationship management (CRM) and branch optimization garnered the most nods in terms of strategic focus areas for 2016. Social media participation as a strategic focus also moved up this year, from 19.9% to 25.5%.

- Mortgage compliance once again earned the top spot regarding bankers' greatest compliance challenge for the year, according to 68.8% of respondents. After major changes from the FFIEC in 2015, vendor management also ranked high, at 42.7%.

- Respondents named data breaches, social engineering schemes and mobile device security as their greatest security concerns going into 2016.

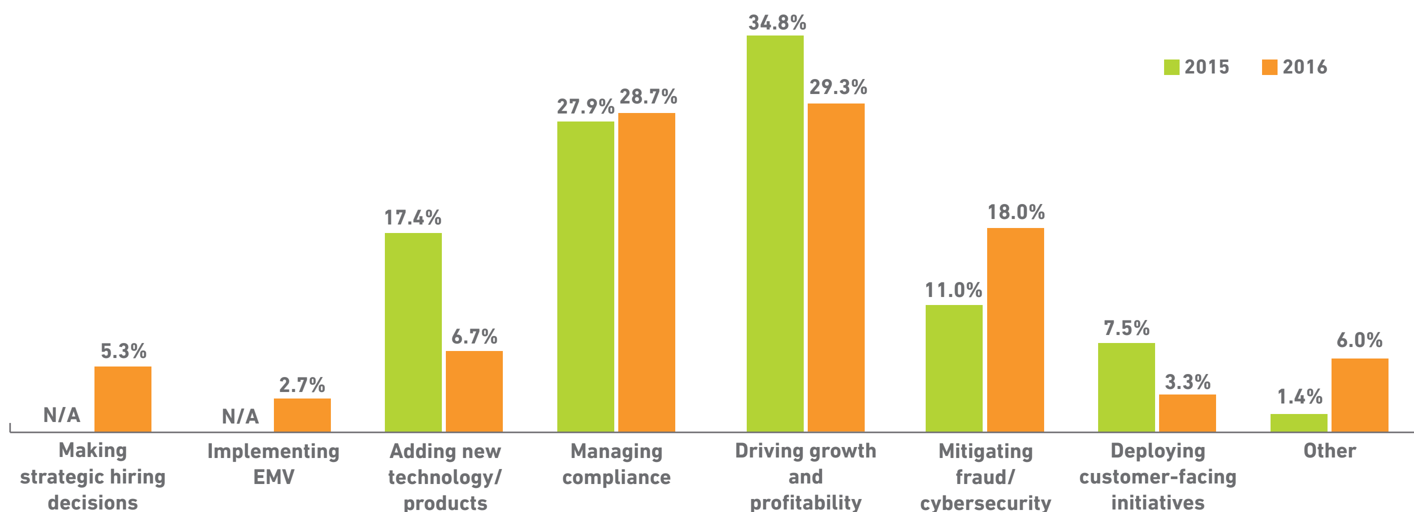
- In keeping with respondents' increased attention toward enhancing mobile/omnichannel banking this year, the majority also named improving mobile and online channels as the one strategy they'll undertake for strengthening customer service.

Detailed Review

The following pages provide detailed analyses of the responses to each survey question.

What are your greatest challenges heading into 2016?

While driving growth and profitability again is viewed as this year's greatest challenge by 29.3% of respondents, that number is a slight drop from last year's 34.8%. This is another indicator that institutions hold a bit more optimism about the economy, and thus, they are more confident in their ability to grow and be profitable.



The FDIC's Quarterly Banking Profile for Third Quarter 2015[1] provides institutions another good reason to celebrate and slowly begin to ease their concerns surrounding profitability and growth. In a Nov. 24 speech[2], FDIC Chairman Martin Gruenberg stated, "Most performance indicators continued to show improvement. Earnings were up from a year ago, loan portfolios grew, asset quality improved, the number of problem banks declined, and only one insured institution failed."

Overall net income was $40.4 billion in the third quarter, 5% higher than this time last year.

However, as with last year, the news is even better for community financial institutions, as their revenue and income growth outpaced the rest of the industry, and their loan portfolios grew at a faster rate compared to their large bank counterparts. The 5,812 community banks reported net income of $5.2 billion, which is 7.5% higher than this time in 2014[3]. The FDIC attributes the increase to improved net interest income and noninterest income, along with lower loan-loss provisions. Net operating revenue, too, was 7.5% higher than last year—at $22.4 billion.

As for other expected challenges recorded in this year's survey, mitigating fraud/cybersecurity climbed to 18%, up from 11% last year. The multitude of high profile data breaches over the last couple of years has brought cybersecurity front and center with regulators, and their concern has trickled down to institutions by way of more scrutiny at exam time.

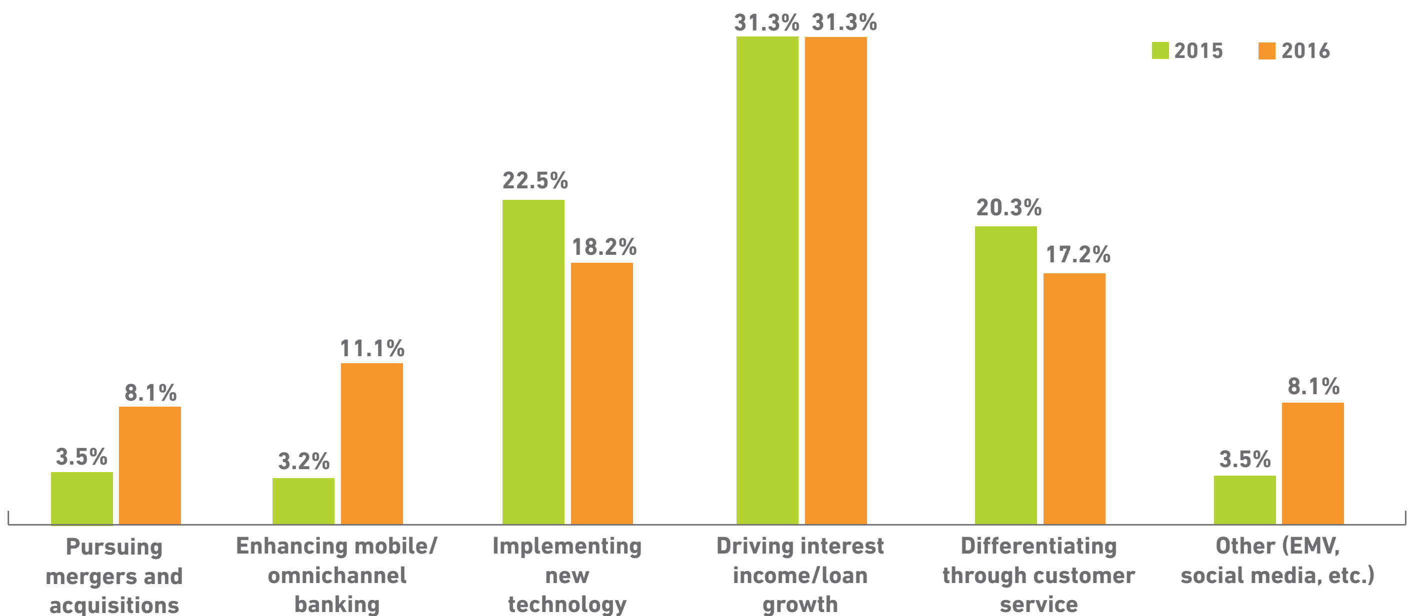
What are your greatest opportunities heading into 2016?

It's no surprise that survey respondents again named driving interest income/loan growth as their greatest opportunity—a mirror image of last year's feedback at exactly 31.3%—because that's how they make money.

Again, the FDIC quarterly report offers justification for this positive outlook, with total loan and lease balances rising by $95.3 billion during the third quarter. Over the past 12 months, loan portfolios grew by 5.9% to $482.2 billion, the largest growth rate since mid-2007 to mid-2008.

Loan growth was even stronger at community banks, where loan balances grew by 8.5% over the past 12 months to $111.1 billion. And community banks continued to hold 44% of all small loans to businesses.

Regarding other top opportunities coming into 2016, it's also a welcome sign to see plans for enhancing mobile/omnichannel banking rising to 11.1%. This shows that the industry has embraced the idea that mobile banking is no longer just another option—it's becoming *the* way banking is done. More and more, consumers are conveying that they are going to do their day-to-day banking via digital channels, saving branch visits for more complex needs.



Further, an omnichannel platform ensures that customers receive consistent service enterprisewide. According to Forrester Group[4], "In companies where no single entity owns the customer, it's natural for each business unit to track its own profitability and customers only within that context—resulting in multiple unassociated IDs for each customer and a failure to share data and insights across business units."

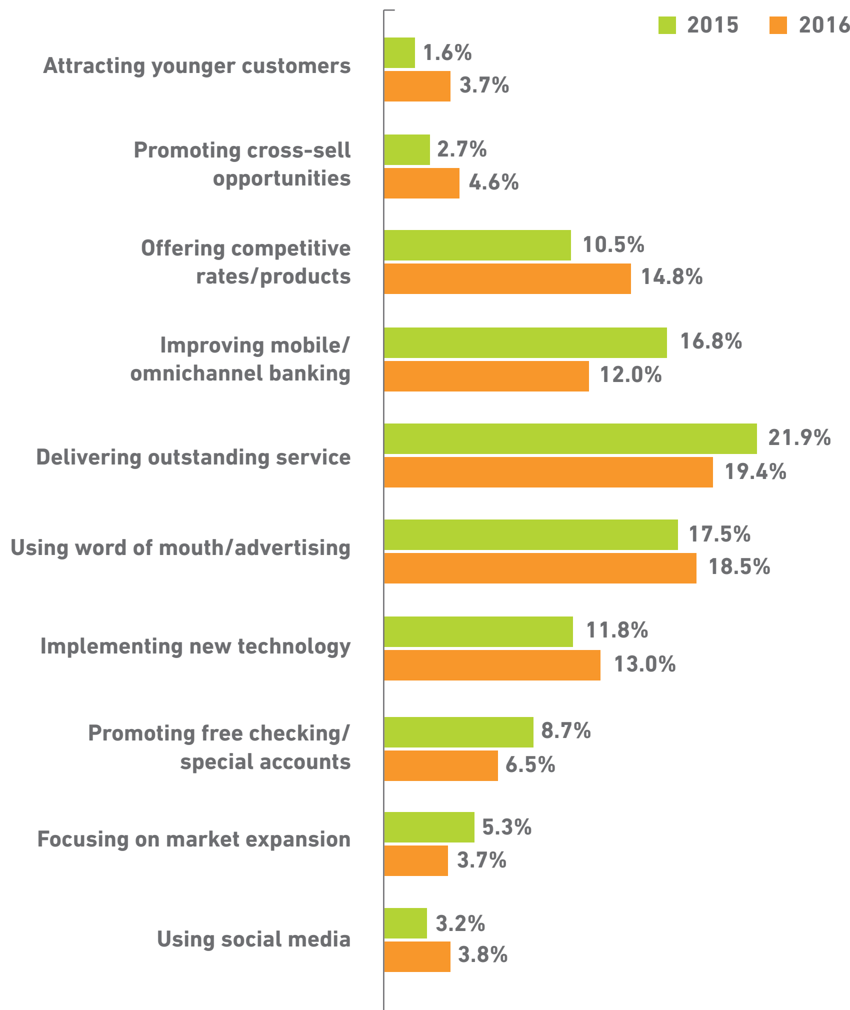
How will you attract new deposit customers in 2016?

Banks and credit unions again intend to go after new deposits using their tried-and-true tactic of delivering outstanding service, according to 19.4% of respondents. This makes sense, because community financial institutions have always differentiated themselves by providing a vastly better customer experience compared to their big box competitors.

Focusing on marketing efforts (18.5%) and offering competitive rates and products (14.8%) also ranked highly for attracting new deposits.

And it's encouraging to see that implementing new technology is gaining ground. That's crucial, because most new deposit customers are, by nature, younger—so if a bank wants a piece of the pie, they must also differentiate through technology. For example, they must reach out through social media and other relevant marketing channels and show prospects that their mobile banking app is the best available, with check capture, P2P and other feature functions that are must-have services for younger customers.

In addition, to attract more small business deposits, institutions must go a step further to provide such solutions as merchant RDC and treasury management technologies that help make their business customers more efficient.



How do you expect non-traditional services (mobile payments, mobile wallets, virtual banks, etc.) to affect profitability?

The responses to this survey question changed slightly from last year, with 40.8% expecting non-traditional services to have a positive impact on their profitability, up from 36% last year. Institutions' increased optimism in this category conveys their understanding that some of these technologies will actually complement their offerings. For instance, if a bank's debit card is in Apple Pay, that's going to drive more transactions through the bank and increase its interchange income.

However, services like PayPal earn the institution no money, which likely accounts for the 28.6% expecting a negative effect from such services. Institutions naturally would much rather see transactions go through their debit cards to keep their share of the profits coming in.

Whether it be a positive or negative effect, financial industry leaders have weighed in on both sides of the coin. Newly elected ABA Chairman Daniel Blanton said in a recent American Banker article[5], "There's an opportunity to partner with (fintech firms) in terms of payments, and the way they do things. It's also a threat of our business model being in danger in terms of them taking business from us."

He went on to suggest that banks either consider ways to team up with the new payments players—or learn how to beat them at their own game.

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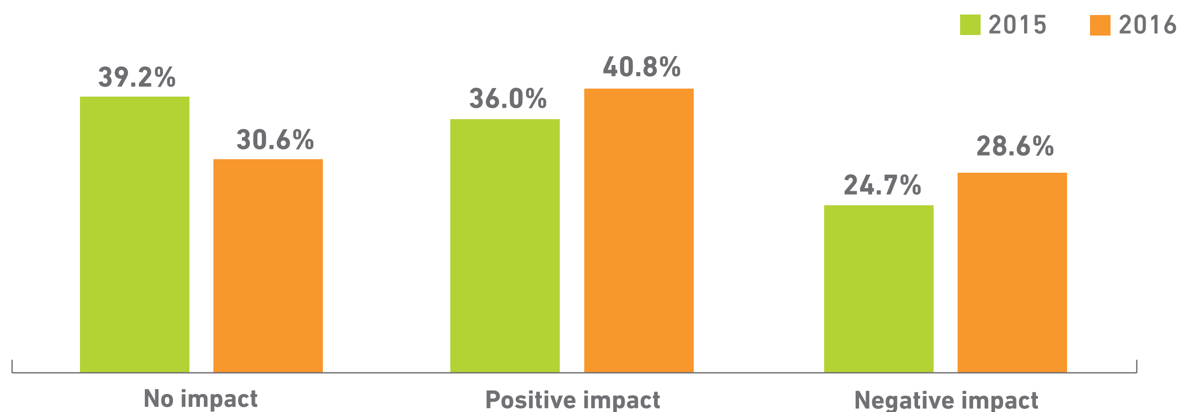
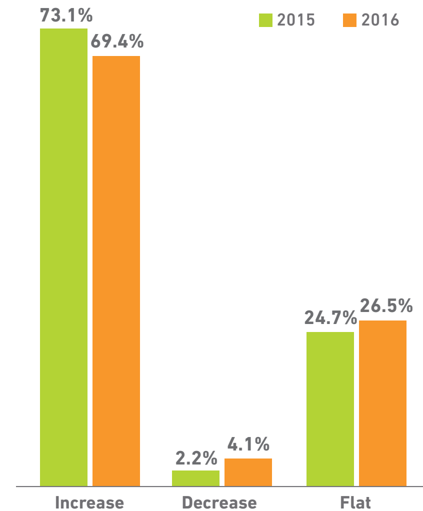


What's your institution's outlook on lending growth in 2016?

As noted on page 4, institutions expect to see a healthy lending environment in 2016. That's with good cause, particularly since data from the FDIC's Quarterly Banking Profile for Third Quarter 2015 shows that community banks expanded their 12-month growth rate in loan and lease balances at almost twice the rate of non-community banks.

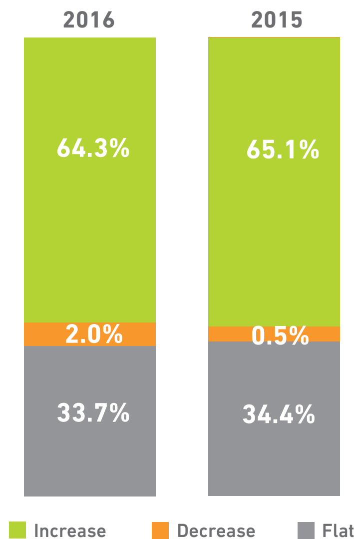


Indeed, 69.4% of survey respondents plan to increase lending this year. However, that is a 3.7% decrease from last year's 73.1%. The Fed's interest rate hike in December is likely the cause, because although financial institutions are optimistic about the continued economic upturn, they're also understandably cautious about how the rate increase will affect loan growth.

Still, the Mortgage Bankers Association (MBA) in November reported that third quarter 2015 commercial and multifamily mortgage loan originations were 12% higher than the same period last year—and went on to forecast a 6% rise of the same for 2016[6]. Further, the MBA forecasts purchase originations will reach $885 billion in 2016, and total originations are expected to reach $1.26 trillion. The association stated, "More sales are being financed, and more applications are being approved. And we expect that this trend will continue into 2016 and beyond, as the broader economy and job market continue to improve.[7]"

What are your plans for technology investment in 2016?

Financial institutions clearly are committed to investing in technology and providing their customers with the most innovative solutions available. In this year's survey, 64.3% of respondents say they have plans to increase spending on technology, while just 2% expect a related decrease.



This falls in line with responses on page 4, where institutions cite implementing new technology as their second greatest opportunity for 2016. And it makes sense, since innovative technology offerings also figure prominently in attracting new deposits and enhancing the service experience.

Further, CSI recently partnered with Harris Poll to conduct a survey[8] of more than 2,000 randomly selected consumers, age 18 and above, nationwide. The survey asked six questions regarding what respondents primarily seek in a banking relationship. Roughly 50% of the consumers surveyed said that technology was a key factor in selecting where they bank, with this percentage jumping to 65% when segmenting male respondents under the age of 35.

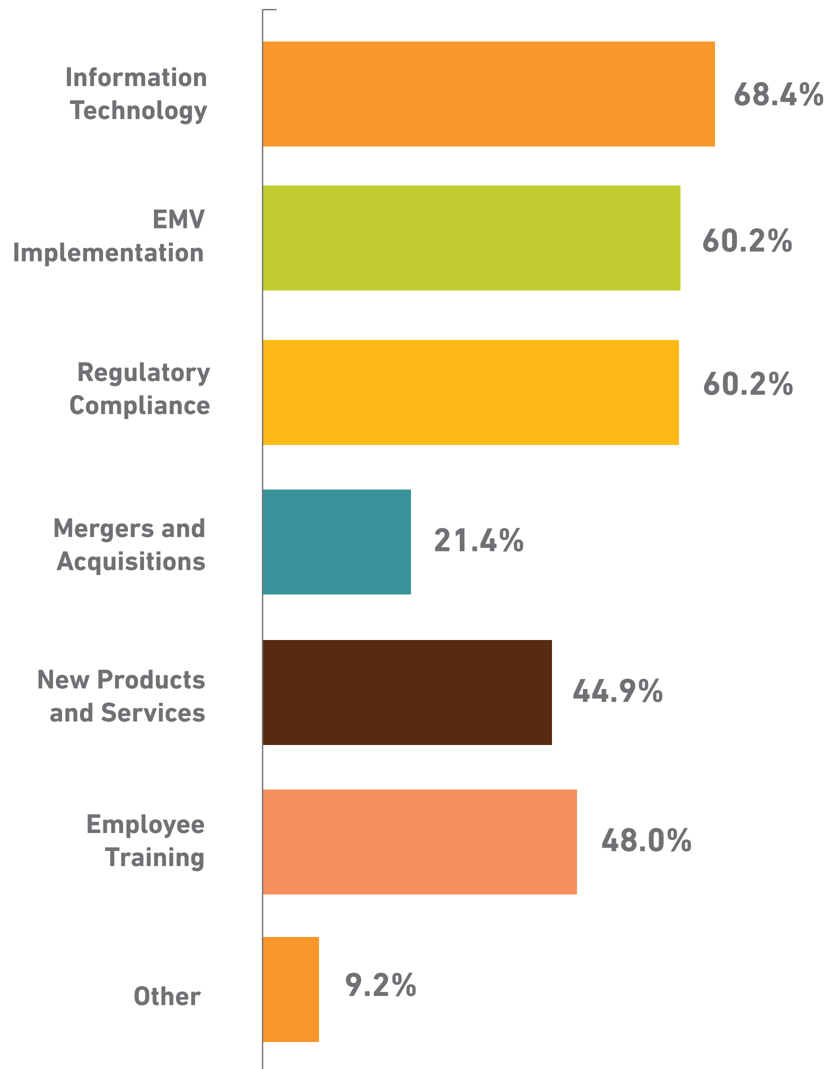
So, it appears plans for technology investment are spot-on. The following question and its responses explore additional planned expenditures for 2016.

New for 2016: In which areas do you expect to increase spending over the next 12 months? (Check all that apply)

As stated in the previous section, spending on information technology in 2016 is set to increase—coming in as the top planned expenditure at 68.4%. EMV implementation and regulatory compliance tied for second place in spending priority at 60.2%.

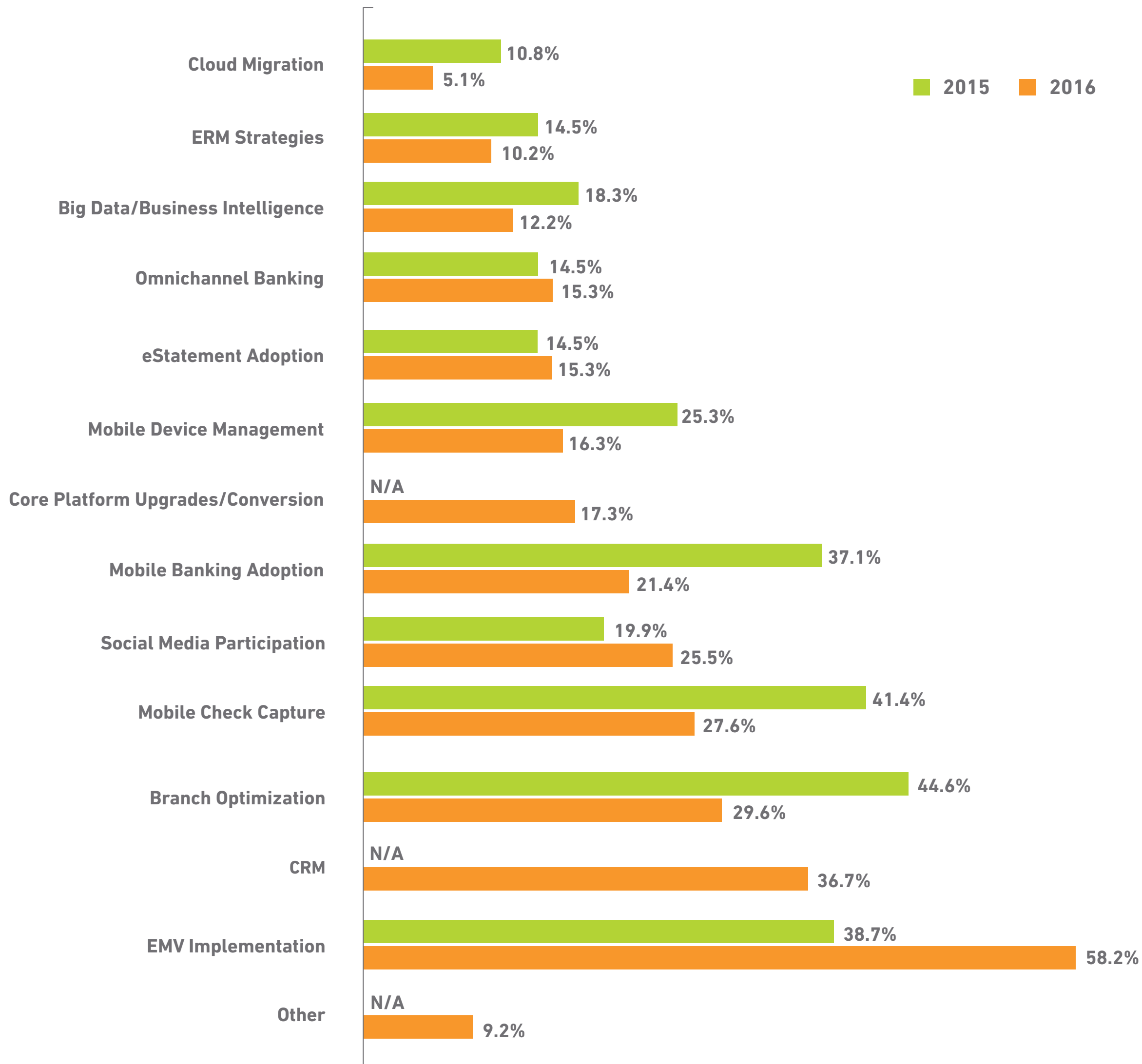
With the strong, industry-wide focus on EMV in the coming year, spurred by the liability shift in October, it's no wonder this new payment methodology figured so highly (EMV is examined in greater detail on page 9).

But what came in as a welcome surprise is employee training, rounding out the top three at 48%. Indeed, as the financial industry increases in complexity, institutions are strongly urged to hire and train at a higher level to ensure their bankers are more "universal" and able to handle everything from home equity loans to simple deposits.



Which of the following areas will be a strategic focus in 2016? (Pick three)

EMV implementation was named the top strategic focus this year at 58.2%, up from last year's 38.7%. October's liability shift has set the EMV wheels in motion, so the new payment methodology will finally enter the U.S. mainstream in 2016.



But while banks are indeed issuing the more secure, chip-enabled debit cards, widespread EMV acceptance largely depends on retailers. According to the Paychex Small Business Snapshot[9], while 75% of consumers have received a chip-enabled card, only 47% of retailers and restaurants have switched to the EMV-compliant card readers—despite most having knowledge of the shift to merchant liability for fraud losses.

It's inevitable that increasing fraud will begin to put a financial strain on retailers, and when the pain becomes too great, more will begin to accept chip cards.

Another important 2016 strategic focus for survey respondents is customer relationship management (CRM), taking second place with 36.7%. This makes sense, since CRM solutions, many now integrated with an institution's core processing platform, allow institutions to more readily anticipate their customers' needs—via their preferred channel—which elevates the service experience.

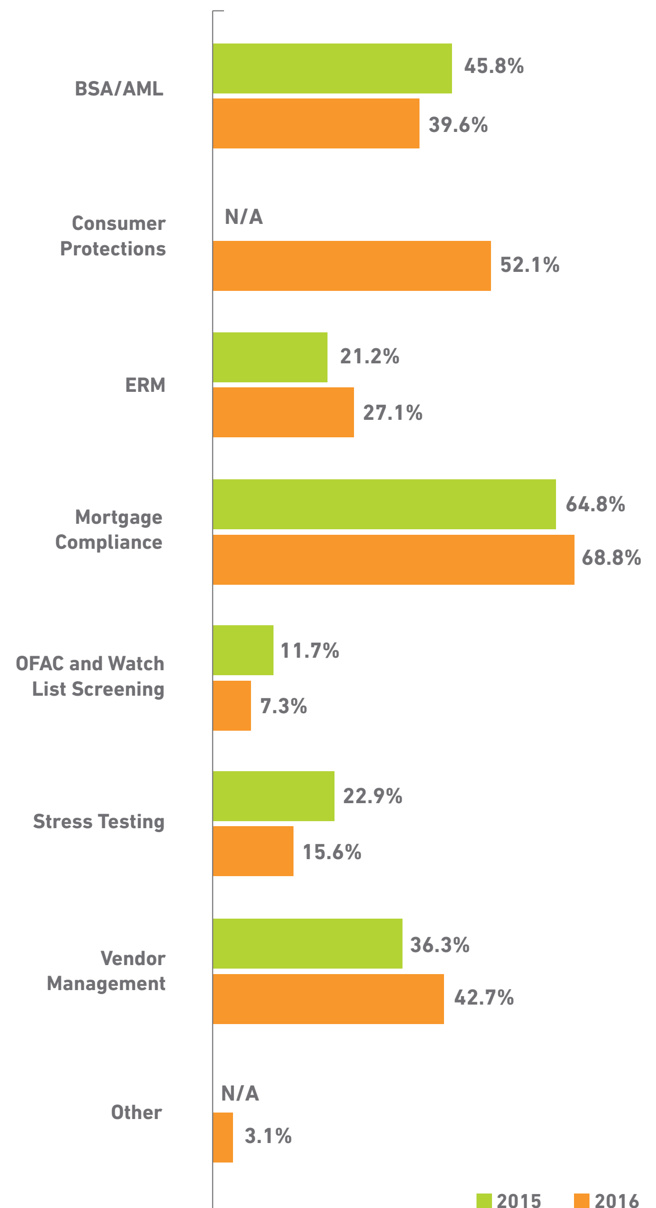
In another interesting turn, social media participation is gaining ground as a strategic focus, rising to 25.5% from 2015's 19.9%. This supports banks' understanding that they can grow new deposits through marketing campaigns on their social media platforms (page 5).

What are your greatest compliance challenges in 2016?

Once again, mortgage compliance is far and away the top compliance concern for financial institutions heading into 2016, coming in at 68.8%—a 4% increase over last year. Respondents' anxiety rests squarely on the TILA-RESPA Integrated Disclosure (TRID) Rule. While the effective date for TRID compliance came and went in October, institutions still are struggling with a multitude of technical questions, searching for additional training and education, and wondering how the rule will affect their loan growth.

A recent CSI Quarterly Compliance Update webinar[10] (available on-demand) offers insight into the important steps needed for managing these new mortgage requirements, like correctly calculating charges to ensure "good-faith" actions and establishing controls to satisfy the timing and method of delivery requirements.

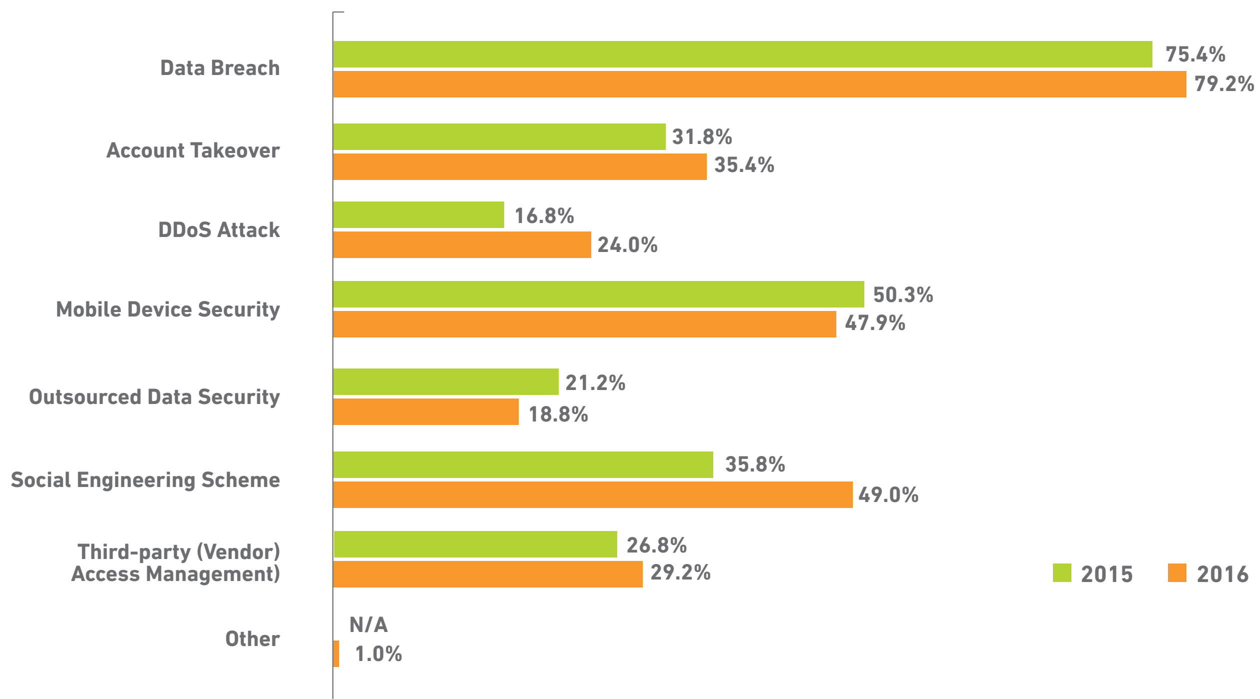
Coming in second regarding respondents' 2016 compliance concerns is the area of consumer protections, which includes cybersecurity, fraud and consumer complaints. Next is vendor management at 42.7%, up 6.4% from 2015. Vendor management angst is centered on the February 2015 publication of the FFIEC IT Handbook's Appendix J, which made financial institutions responsible for ensuring the solidity of their technology service providers' BCPs. Further, the agency's recently updated Management booklet states that banks are ultimately responsible for any actions completed by technology service providers on their behalf.



What are your top security concerns for 2016? (Check all that apply)

Frankly, there were few surprises in how survey respondents listed their top security concerns. Fear of data breaches again was named the biggest worry for the overwhelming majority (79.2%). It's been some time since the industry has suffered a significant card breach, but the memory of the Target event—and the multitude of significant data breaches that followed—still stings. Financial institutions are concerned not only with resulting financial consequences, but also with damage to their market reputation.

Also, social engineering schemes climbed to 49% from last year's 35.8%, which makes sense since many data breaches are born from successful social engineering ploys like phishing emails, a favorite of hackers. Verizon's 2015 Data Breach Investigations Report[11], which analyzes evidence collected during external forensic investigations, showed that 23% of recipients opened phishing messages and 11% clicked on attachments. These numbers are slightly higher than last year's.



What should institutions do? Hire a trusted vendor to conduct thorough social engineering testing and determine weak spots, then implement a solid employee awareness and training program.

In CSI's Harris Poll survey, a full 80% of consumers surveyed cited a financial institution's ability to ensure the safety of their financial information as their greatest concern, regardless of demographic. Obviously, data security is top of mind for consumers, too.

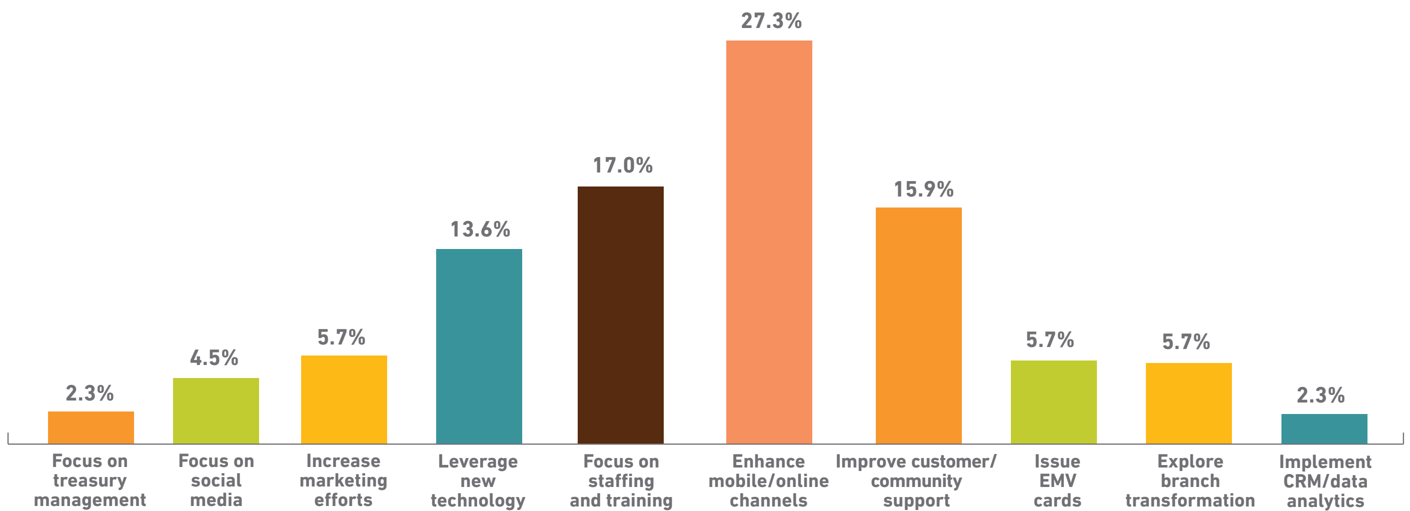
The biggest surprise here lies with mobile device security. While financial institutions continue to view mobile device security with lingering unease (47.9%), this number is down slightly, even though mobile devices are projected to stay near the top for security risks over the next year. With so many consumers using devices for everything from chatting with friends to depositing checks, threats continue to rise through malicious apps, outdated software, and loss or theft.

New for 2016: What one strategy will your institution undertake in the next 12 months to enhance the service experience for customers?

Institutions indicated elsewhere in this survey that providing outstanding service is both their top tactic planned for attracting new deposit customers and one of their greatest opportunities heading into 2016. Here, respondents most often (27.3%) cited enhancing mobile and online channels as their main strategy for elevating the service experience—a welcome sign of the importance institutions are placing on innovative channel enhancements.

An institution's digital channels must be the best out there, because that's how people interact with their bank each and every day. Comment after comment from this year's survey shows banks and credit unions resolutely agree:

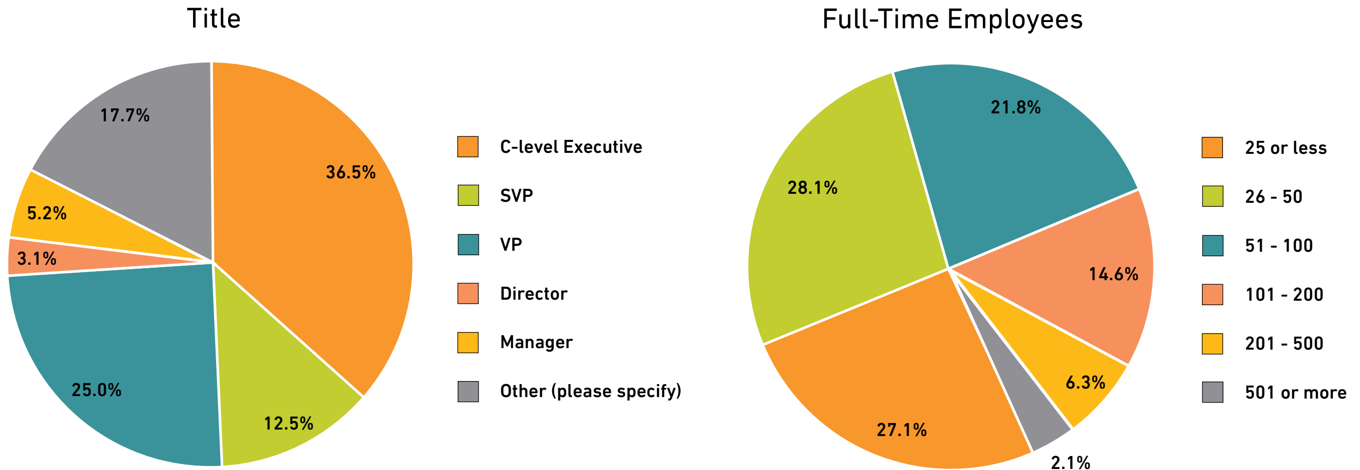
- "Offering an innovative approach to compete for the next generation of customers"
- "Adopting the most advanced technology available to us"
- "Implementing an omnichannel service model"
- "Creating a consistent feel to all avenues in which our bank is accessed"
- "Optimizing online and mobile offerings"



Further, while leveraging new technology (13.6%) certainly plays a significant role in raising the bar on digital channels, it can reach much further toward satisfying customers. For example, the availability of secure wireless networks and core-linked mobile tablets can rejuvenate the branch experience. Nothing replaces the feeling you get when you walk into a branch and see a banker right there holding a tablet, ready to help with every need or problem. That's what innovative technology is all about.

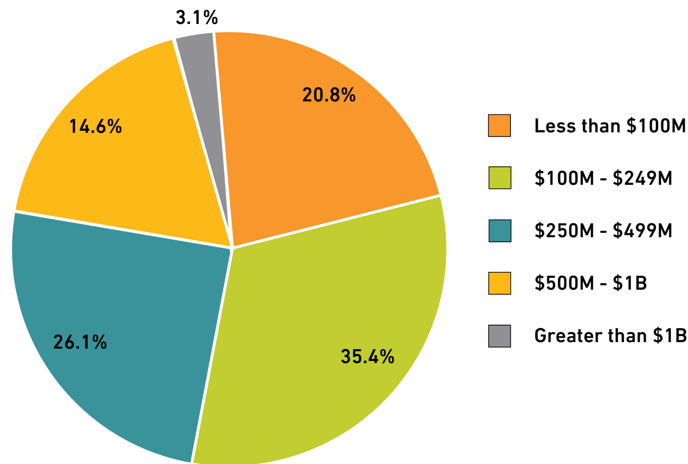
Demographics

The Executive Report: 2016 Banking Priorities Study represents feedback from 101 respondents, 74% of whom identified themselves as a vice president or higher at a U.S. financial institution. Another 8.3% of respondents are either a director or manager at a financial institution. Further, 77.1% indicate they work in an institution with 100 or fewer full-time employees, while the remainder are in an institution with more than 100 FTEs.



Asset Size

Of this year's respondents, 56.2% work at institutions with up to $249 million in assets. Another 26.1% are from institutions with an asset size between $250 million and $499 million; 14.6% are from institutions with $500 million to $1 billion in assets, and 3.1% stated their asset size as greater than $1 billion.



About CSI

Computer Services, Inc. (CSI) delivers core processing, managed services, mobile and Internet solutions, payments processing, print and electronic distribution, and regulatory compliance solutions to financial institutions and corporate customers across the nation. Exceptional service, dynamic solutions and superior results are the foundation of CSI's reputation and have resulted in the company's inclusion in such top industry-wide rankings as the FinTech 100, Talkin' Cloud 100 and MSPmentor Top 501 Global Managed Service Providers List. CSI's stock is traded on OTCQX under the symbol CSVI.

For more information about CSI, visit www.csiweb.com.

References

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