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AI in banking: 6 key challenges and opportunities

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John van Boxmeer, Director, Credit Research
Owen Ko, Director, Equity Research

Key takeaways

- The financial services industry has significant potential to substitute low-value-added tasks with Artificial Intelligence (AI). Outcomes will depend more on execution quality and risk management than speed of deployment.
- Efficiency gains are expected to be significant as banks have line-of-sight to upwards of $1billion annual value creation in the medium-term.
- AI introduces both improved risk detection and more sophisticated fraud
- The impact of AI will differ for equity and credit investors: equities are more exposed to earnings variability, while credit is more sensitive to downside risks.
- While AI is strategically important, **it is not yet a primary driver of portfolio positioning**, and the eventual winners and losers remain unclear.

Why AI matters for investors

Artificial intelligence is one of the most important long-term developments re-shaping the economy, especially the banking sector. While much of the public discussion focuses on efficiency gains and customer applications, the implications for investors are broader.

The key implication is that AI is more likely to affect the **timing, variability, and dispersion of bank earnings** than their long-term solvency. Banks are not likely to be disintermediated by AI, but by leveraging AI the industry will be able to improve efficiency, enhance the customer experience, and fortify cybersecurity and risk mitigation (fraud detection). Equity investors should expect outcomes to diverge based on execution, while credit investors should focus on downside risks related to cybersecurity, operational failures, and credit quality.

At this stage, however, **AI-related factors are not yet playing a significant role in portfolio weighting decisions**, reflecting both the early stage of measurable financial impact and the difficulty in identifying clear winners.

Since banks represent nearly 30% of major Canadian equity and bond indices, these dynamics are relevant across portfolios.

How we expect AI to impact equities vs. credit

Theme	Equity implications	Credit implications
Efficiency	Drives operating leverage and long-term ROE	Gradual improvement in earnings stability
Customer experience	Revenue growth, retention, valuation multiples	Less direct impact
Risk & fraud	Earnings volatility, reputational risk	Key for loss stability and capital
Cybersecurity	Cost pressure and tail risk to valuation	Major downside risk (operational losses, credit ratings)
Credit impacts	Provision volatility, cyclical earnings	Direct impact on losses, Common Equity Tier 1 (CET1) ratios, spreads
Competition	Determines long-term winners	Relevant if franchise strength erodes

Potential timeline of AI impact

- **0–2 years:** Rising costs (technology, cybersecurity), gradual efficiency gains
- **3–5 years:** Measurable productivity improvements and early cost leverage
- **5+ years:** Potential structural ROE improvement, though benefits likely shared across the industry

This pattern is broadly consistent with prior banking technology cycles, such as mobile banking and digitization, where investment precedes measurable returns.

Below, we broadly examine six key challenges and opportunities facing the banking industry:

1. Efficiency and productivity

International Labour Organization (ILO) research shows that financial services is among the sectors best positioned to use AI for automating low-value tasks. This positions banks and insurers to capture greater efficiency gains than most industries, which could provide a sector-level advantage for both equity and credit investors. The clearest near-term benefit from using AI is improved efficiency. Banks operate large administrative infrastructures across customer service, compliance, payments, underwriting support, and reporting.

AI can automate or accelerate many of these processes, including:

- Underwriting and lending decisions
- Portfolio management
- Macro and fundamental investment research
- Compliance monitoring and Anti-Money Laundering (AML) reviews
- Document processing
- Fraud detection
- Middle- and back-office operations

AI will likely shift employment away from repetitive tasks toward oversight, governance, and technical roles. In many cases, AI will augment rather than replace employees, improving productivity of relationship managers, underwriters, and service staff.

Some of the big Canadian banks have disclosed expected AI impacts, predicting up to $1B in annual value creation over time:

AI-related financial disclosure

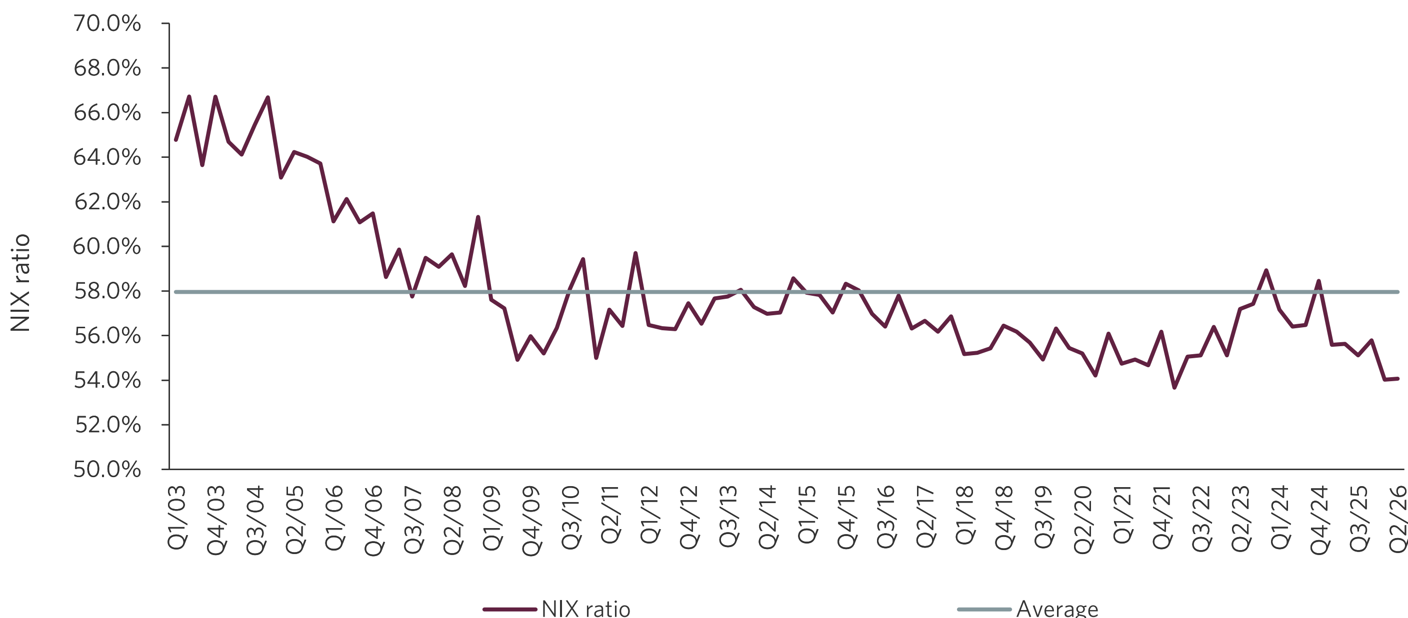
Bank	Financial Impact	Timeline / Detail	As % of F25 Earnings
BMO	$1B+ PPPT*	By F2030	11%
RY	$700mn to $1B EV**	By F2027	3% - 5%
TD	$1B Annual value	50% revenue / 50% cost savings	7%

Source: Company financials, June 2026. *PPPT = pre-provision, pre-tax earnings. **EV = enterprise value

These are material improvements likely to extend the efficiency gains big banks have seen over the past 25 years, as shown in the following chart.

Investor implication: Efficiency gains are real but will likely emerge gradually, while upfront costs rise.

Big 6 Canadian banks: Net interest expense (NIX) ratio



Source: Company reports. June 2026.

2. **Customer experience**

AI enables more personalized banking through better use of customer data.

- Retail clients may gain access to more scalable financial guidance
- Advisors may benefit from AI-assisted preparation and recommendations
- Banks can deliver more responsive and customized service

However, many of these capabilities are being adopted industry-wide, suggesting limited long-term differentiation.

Investor implication: Customer-facing AI is more likely to **protect market share than create durable competitive advantage.**

3. **Risk management and fraud**

AI is improving banks' ability to detect fraud and monitor risk by identifying unusual patterns faster than traditional systems.

Applications include:

- Underwriting support
- Claims analysis
- Compliance surveillance
- Cybersecurity monitoring

However, risks are also increasing and can be caused by model bias in lending decisions, regulatory scrutiny around explainability, and reputational risks from errors. Human oversight remains critical.

Investor implication: AI strengthens risk management but introduces new regulatory and operational risks that must be carefully controlled.

4. **Cybersecurity**

AI is accelerating the sophistication of cyber threats, including:

- Phishing and identity fraud
- Voice cloning and deepfakes
- Automated attack scaling

Banks must increase spending to keep pace with evolving threats.

Investor implication: Cybersecurity is one of the most material near-term risks, with potential for large operational losses and reputational damage.

5. **Credit impacts**

Banks are not only adopting AI—they are financing its expansion across the economy.

This creates both opportunities and risks.

Loan portfolios most exposed to AI disruption include the following:

- **Consumer unsecured lending (credit cards, auto):** most sensitive to employment disruption
- **Residential mortgages:** indirect exposure via unemployment
- **Commercial real estate (office):** vulnerable if automation reduces space demand
- **Corporate lending:** sector-specific disruption risk
- **AI infrastructure lending (data centres, energy):** potential growth area

If AI leads to workforce displacement in certain sectors, it could increase delinquencies and loan losses over time.

Investor implication: Credit impacts are likely **medium-term risks**, but potentially significant if economic disruption is broad.

6. Competition and execution risk

Large Canadian banks benefit from scale, funding advantages, and robust customer data. However, AI is lowering barriers in some areas, enabling smaller players and fintechs to compete.

Durability of competitive advantages

Advantage	Strength today	AI impact
Proprietary data	Strong	Moderate
Regulatory relationships	Very strong	Likely strengthened
Balance sheet strength	Very strong	Unchanged advantage
Technology scale	Strong	Advantage narrows over time

Execution risk is critical. Moving too slow risks falling behind, while moving too quickly risks operational failures.

Investor implication: While AI may increase dispersion across banks, **it remains too early to confidently identify long-term winners and losers.**

AI risk prioritization

Risk	Prioritization: Near-term (0-2 yrs)	Prioritization: Medium-term (3-5 yrs)
Cybersecurity	High	High
Execution risk	High	Medium
Cost pressure	High	Medium
Credit disruption	Low	High
Competitive erosion	Medium	Medium

Key metrics to monitor going forward

Advisors should focus on measurable indicators of AI success:

Indicators	Metrics
Efficiency	• Cost-to-income ratio • Headcount vs revenue growth • Technology and cybersecurity spending
Revenue / client servicing and acquisition	• Digital sales penetration • Cross-sell ratios • Client acquisition cost
Risk	• Fraud losses • Operational risk losses • Value-at-Risk (VAR) / trading day gains volatility
Credit	• Provision for credit losses (PCL) • Delinquency trends in exposed sectors • CET1 capital ratios
Execution	• Disclosed AI ROI vs realized savings • Processing time reductions

At present, however, **disclosure across banks remains limited and inconsistent,** making it difficult to compare progress and assess which institutions are executing most effectively.

Additional considerations

The implications of AI for banks extend beyond the themes discussed here. Other important considerations include regulatory developments, vendor concentration risk, model governance frameworks, and broader macroeconomic impacts.

As a result, this article should be viewed as an initial framework rather than an exhaustive assessment of AI's impact on the banking sector.

How should investors be positioned?

With likely further improvement in the industry NIX ratio, as well as revenue uplift, based on current disclosure the medium-term benefits of using AI in the banking sector will be sizable. We anticipate mid-single-digit to double-digit bank annual earnings on average over the next several years. Overall, AI is likely to be a net positive for the banking sector, but the path forward will be uneven.

- **Equity investors** should expect variability in earnings and valuation outcomes based on execution
- **Credit investors** should focus on downside risks, particularly cybersecurity, operational failures, and credit quality

Given the sector's large weight in Canadian portfolios, maintaining exposure remains important. However, **AI is not yet a primary driver of portfolio allocation decisions**, and differentiation across institutions may take time to emerge.

Bottom line

AI will become deeply embedded across banking operations. The long-term winners are unlikely to be those adopting AI the fastest, but those implementing it thoughtfully—balancing efficiency gains with strong risk controls, regulatory compliance, and customer trust.

At this stage, **the ultimate winners and losers remain difficult to identify**, reinforcing the importance of disciplined monitoring as the investment case evolves.

Looking beyond individual bank execution, the sector itself may be structurally advantaged. ILO research points to financial services as one of the industries with the greatest capacity to absorb AI-driven automation of routine tasks. This dynamic could make the financial services sector relative outperformers in an AI-driven economy. The long-term investment case for the sector is therefore not solely dependent on identifying which individual bank wins, but on recognizing that the industry as a whole may be better positioned than most to convert AI investment into durable earnings improvement.

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