

The changing shape of international banking and the future of Europe

Bank Governance Leadership
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In many ways, Brexit was the last thing banking needed.

—Participant

Banks have been on a long journey of recovery since the financial crisis: raising capital, restructuring, transforming their systems, and refining their strategies. Part of that journey includes questions about international operations. Today, increasing political volatility—particularly the disruption from Brexit—another round of new regulations, and persistent questions about technological transformation of banking are the top-of-mind issues confronting banks operating in Europe. In a recent discussion, a director stated, *“International models are again being reconsidered.”*

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– Director

On November 28, 2017, BGLN participants met in London to discuss the issues facing banks operating globally, the implications of Brexit for financial services in the United Kingdom and European Union (EU), and the broader trends impacting banking. Over dinner, BGLN participants were joined by participants from the Insurance Governance Leadership Network (IGLN) for a discussion with Lord Jonathan Hill, the former European commissioner for financial stability, financial services, and capital markets union. This *ViewPoints* covers highlights from the discussion on November 28 as well as in calls with network participants in preparation for, and immediately following, that meeting. It is organized in the following sections:

- **Banks are planning for post-Brexit Europe**
- **Regulation and policy remain in flux, with more fragmentation possible**
- **Global banking models are being challenged**

Banks are planning for post-Brexit Europe

The departure of the United Kingdom from the EU will mean that Europe's preeminent financial center will soon be outside the EU. Bank leaders must make decisions regarding operating and governance structures for UK and European operations without knowing the outcome of negotiations.

Uncertainty persists as to how Brexit will play out

For now, bank leaders and their regulators must manage through uncertainty as to what near-term and long-term political and regulatory structures will ultimately look like. Prior to the discussion on November 28, a participant observed, *"There are two quite different issues: one, what is the transitional arrangement, and what can we expect in the near term, and two, what happens thereafter?"* Financial services leaders pressed for clarity by the end of 2017, but negotiations continue. Regulators have reportedly asked institutions to produce contingency plans for their worst-case scenario—a "hard Brexit" in which the United Kingdom gets no special trade agreements with the EU.

"Will the UK regulators ... allow branching into the UK for EU-headquartered banks?"

– Participant

The Bank of England's "reasonable scenario" for the impact of Brexit on financial services is dire: a loss of up to 75,000 financial services jobs in the United Kingdom, with estimates varying depending on whether there is a specific financial services deal between the UK and EU, with 10,000 lost "on 'day one.'"¹ Public statements from some firms suggest the initial blow to the City may not be as devastating as that report suggests, however. JPMorgan initially said it might have to move 4,000 jobs, but subsequently reduced that number to around 1,000. UBS said it may move as few as 250 jobs, after initially planning to relocate as many as 1,000.²

It is unclear what kinds of operating structures will be allowed under different scenarios (e.g., a hard Brexit, or where some agreement is reached on passporting for financial services). Participants raised the following questions:

- **What options for legal structures will be available?** A participant asked, *"Will the UK regulators determine that they can rely on the single supervisory mechanism and allow branching into the UK for EU-headquartered banks?"* One approach some banks are reportedly exploring has been dubbed "branch back," whereby foreign banks would set up new legal headquarters in the EU, but retain most of their people and operations in London. Branch back is essentially a reversal of the current setup, in which many US banks use their London operations to passport their services across the rest of the EU. Participants generally agreed with one who asserted that branch back will not be allowed by the European Central Bank (ECB). In a

“Regulators are as uncertain as we are as to what their political masters will allow them to do.”

– Participant

“You have to be proactive regarding your business strategy. Stalling for regulatory clarification is a dangerous game.”

– Participant

discussion before the meeting, a regulator noted that the UK regulatory regime and that of the eurozone are currently considered legally equivalent: *“If there is a gap, then there is a problem. We might then decide we want to ask for something more than a branch.”*

- **Will European regulators be capable of supervising new entities?** In a discussion before the meeting, a bank chairman asked, *“How do you persuade international regulators in the right place to have an international company? Dublin admitted they don’t have the staff to supervise an international wholesale bank. They don’t have the capability. People have to recognize that for a midsize-and-above wholesale bank, you need to be in a country with a credible regulator and where talent is willing to go.”* In the meeting, a participant wondered how even major regulators such as the ECB will handle an influx of new bank applications and review internal capital models.
- **How will regulators deal with political uncertainty?** Regulators are unable to provide any guidance to banks about what is likely to be allowed because, as one participant observed, *“Regulators are as uncertain as we are as to what their political masters will allow them to do.”*
- **Will promises be kept?** One participant said, *“For the regulators across Europe, this is a competitive-marketing exercise. They may say things that sound good today, but that could be different than what they say three to five years from now. They may change their mind.”* Another participant said, *“National regulatory authorities are trying to be faster, more accommodating.”* Felix Hufeld, the president of BaFin, Germany’s financial regulator, has pushed back on the marketing characterization, saying, *“We are not a marketing agency and not interested in doing industrial policy.”*³ Although BaFin is flexible, Hufeld outlined some limitations: *“One fundamental principle is that we won’t accept a pure ‘letterbox’ approach, with banks setting up a token presence in Germany.”*⁴

Banks are moving ahead with plans despite uncertainty

One participant said, *“We are getting to the point in time where people will start moving, implementing plans with incomplete information by spring 2018 because we are running out of time.”* Another asserted, *“You have to be proactive regarding your business strategy. Stalling for regulatory clarification is a dangerous game.”* Dangerous, because, as another participant noted, *“There are competitive issues. EU-headquartered banks are saying to clients, ‘We can provide certainty.’ No one is taking their foot off the gas.”*

“Do we understand what regulatory permissions we need, how the booking model works, and how to operate across borders?”

– Directors

Participants acknowledged that the costs of making decisions now based on a worst-case scenario that does not come to pass could be high. One participant said that to protect against those costs, *“we are working to a strategy of minimum regret. But there is still a high risk of regret if you make the wrong decision.”* Another participant concurred: *“A hard Brexit would be very painful for many institutions,”* requiring that institutions *“plan for the worst and hope for the bad.”*

As plans are formulated, boards have many questions: *“How is risk being allocated? Why have firms structured activities the way they did, where they did? ... Do we understand what regulatory permissions we need, how the booking model works, and how to operate across borders?”*

Regulatory and legal structures could complicate decisions regarding what activities may need to move and how to move them. The details are important. A participant observed, *“Financial regulation is very complex. If you take, for example, clearing euro derivatives, the French argue it has to be in Paris for financial stability reasons, to ensure oversight within the euro area. But you would not want to move that in a hurry. It isn’t so much building the infrastructure; it is as much that I don’t think you can transfer these positions legally. So, you have to take all the open risk positions, close them out, then reopen them. Never mind the documentation issues. It is quite a machine.”*

Financial services centers are likely to spread across Europe

“You will move assets across the channel. But to do that, you need to build the systems, and that takes time.”

– Participant

At least in the near term, no one expects London to cease being one of the most important financial centers in the world, regardless of the outcome of Brexit negotiations. The infrastructure in London will be difficult to match in the short term. A participant said, *“You will move assets across the channel. But to do that, you need to build the systems, and that takes time. It won’t be done tomorrow.”*

Yet, the race is clearly on to attract desired high-paying financial services jobs and tax revenue. A participant stated, *“Brexit is a zero-sum game: To the extent the UK does better, France and Germany lose.”* Another participant quipped that as a result, *“Euronext is rubbing their hands.”*

The extent to which London loses EU market access may hinge on how confident EU political leaders are that they can duplicate London’s infrastructure. A participant asked, *“What will you do if you lock out the EU from the main financial center in Europe? How will the EU fund things? As Mark Carney pointed out, all the infrastructure is in London. That is a genuine question for the EU: whether they are willing to accept an offshore financial center.”*

Some see an opportunity for other European cities to become specialized centers for particular businesses and activities. For now, most boards are focused on more immediate and short-term implications of Brexit, but in

the long term, banks will have to consider where to locate which business activities, not for legal or regulatory reasons, but because talent and infrastructure could begin to concentrate in new places.

Discussion with Lord Hill

Over dinner on November 28, participants in the Bank and Insurance Governance Leadership Networks were joined by Lord Jonathan Hill, until July 2016 the European commissioner for Financial Stability, Financial Services, and Capital Markets Union. Lord Hill shared his perspectives on the state of Brexit negotiations, the potential outcomes and likely implications for financial services, and the future of the United Kingdom and European Union after Brexit. His comments are summarized below:

- **The departure of the United Kingdom from the EU may have been inevitable.** *“Looking back, the UK's decision not to join the euro put us on a different path: thereafter, we were never at the top table in the same way. Maybe the crunch was always going to come and the referendum just accelerated it”*
- **Politicians have not been forthright about Brexit.** *“There has been a failure to be honest about the choices we have to face. If you go all the way back to the referendum campaigns, leaving was presented as a catastrophe or a liberation. We haven't recognized that there will be winners and losers. We should have been honest about those choices, about how to minimize losses and accelerate gains. There are always winners and losers in politics, so pretending that isn't the case is not productive ... I don't think it's a binary thing where we're either slaves or Singapore. That's silly and not the case at all ... I think when there is a real will to solve this on both sides ... It should certainly be solvable. The fact that we have time pressures will concentrate minds.”*
- **Negotiations have been marred by politics.** *“From the EU point of view, we are pursuing a cake-eating strategy. We want the unique better deal. The EU thinks we have already got a better deal than other countries. Although some people in the UK believed that the UK always got a bad deal and didn't have any say in EU regulation, it simply wasn't true. The fact is, the influence of the UK in the EU system when it comes to shaping law and regulations was significant. That will be gone ... If I was advising the UK, at this point, I would say: stop pretending that you can get a deal that gives you everything you want, but get the best deal that you can and work from there. There are a whole lot of things that become fixable once you get past the politics. If you can sort the politics, the technical solution can become possible ... The election result in June was disastrous. Now we are in a mess. It was a disaster from the negotiation point of view. For the EU, the key is to crack on and do the deal with Theresa May. A new government is not going to be any better.”*

Discussion with Lord Hill contd.

- **The United Kingdom will need to adapt to a dynamic post-Brexit regulatory environment.** *“The rules will not be static after the separation, and we will be increasingly uncomfortable with the direction of EU regulation, especially in financial services. I’m seeing signs of the EU going back to familiar themes, like a financial transaction tax, the convergence of labor laws, and social welfare. Now that we are not at the table, we will be out of step with future EU policies and can’t carry on as if nothing happened ... We can’t tie ourselves to a regulatory system over which we have no control. We should make sure we are creating an environment that is conducive to fintech, for example. There are opportunities here to be an attractive place to do business. We are better positioned to think about innovating in fintech, given that the EU approach is to define it as a risk and try to eliminate it.”*
- **New York and Asia are likely to benefit most from a shift of financial services out of London.** *“In the big picture, the main beneficiaries [of Brexit] are New York and Asia ... I think France wants to be the financial center for the EU. Frankly I don’t think Germany wants it. Germany doesn’t like capital markets and doesn’t trust them. If it’s going to blow up, they would prefer it to happen over in London and not in Frankfurt. The question is, Who will be the dominant player on financial services without the UK? I would say France ... I think you’ll end up with a single capital markets regulator in the EU.”*
- **The longer-term impact on UK financial services is uncertain.** *“Brexit is a second-order issue, and we need to think about how to attract the right people and give them access to capital. That’s what we should be concentrating on. We are eroding some of our reputational value around the world. The good thing about us leaving is we will not have anyone else to blame. No more playing the victim.”*
- **Brexit is forcing companies to address lingering issues.** *“What a lot of businesses are finding is that even if their business is not directly affected by Brexit, it is forcing them to face issues that they really should have before. In the long run, it might be better for these companies to face these issues now.”*
- **Further EU integration will be limited in the near term.** *“Some in the European Union say, ‘Now’s the moment to define ourselves against Brexit and Trump.’ But how do you apply that to real issues like EU government, or the banking union? Merkel is less able to push that now, after the election. Germany is preoccupied with other issues, like addressing immigration, so their ability to push for a stronger union will be limited”*

Regulation and policy remain in flux, with more fragmentation possible

Political risk is likely to remain an important issue for banks, as is the global reform agenda. Although the latter is finally nearing completion, major regulatory changes are still coming in the years ahead that will have important implications for bank operating and business models.

Geopolitical uncertainty and volatility is likely to persist

Although clearly important in its own right, Brexit is also just one manifestation of broader structural shifts in Europe and globally. Speaking about the new salience of political risk, a participant stated, *“Politics is the new economics ... We used to look at GDP, employment rates. Now we look at opinion polls.”* While the wave of populism and nationalism that swept across global politics in 2016 has subsided, additional political upheaval in Europe is possible: *“People think the EU crisis is gone. It is just hibernating. Catalonia is a reminder of that,”* cautioned a participant. *“We dodged a bullet in France, but Macron must be successful or Le Pen is lurking right behind.”*

“We used to look at GDP, employment rates. Now we look at opinion polls.”

– Participant

Some participants expressed concern that in the United Kingdom, the Conservative Party’s loss of 13 parliamentary seats in the June 2017 general election may mark the start of a trend eventually leading to a victory for the Labour Party under Jeremy Corbyn’s leadership. One said, *“Corbynomics will impact where people keep assets,”* suggesting more money could leave London in such a scenario. Discussing the biggest political risks for 2018, political consultant Ian Bremmer said, *“If Jeremy Corbyn actually becomes prime minister, that’s probably worse for the United Kingdom than the Brexit negotiation.”*⁵

One participant reflected on the macroeconomic context in which Brexit is taking place: *“This is happening at a time when quantitative easing is ending, the ECB may be backing off of their stimulus measures, [and] there is a big, structural macroeconomic shift going on in the background.”* Another said, *“We are looking at how Brexit intersects with ring fencing in the UK and the economic scenario you plug into your models.”* As another noted, *“The impact on the UK could be significant to our customer base.”*

Integrating geopolitics into risk governance

“Risk management has evolved. It’s not just about [value at risk] anymore.”

– Participant

Two of the mainstays of political and economic stability, the United States and United Kingdom, are now *“embracing irrational decision making,”* according to one participant, who asked, *“How are you managing and governing in that environment? Boards and risk managers genuinely need to consider that.”* Directors said that they are spending more time considering a broader range of political scenarios in risk committee and board discussions. One participant observed, *“Risk management has evolved. It’s not just about [value at risk] anymore. We are using scenario analysis and stress testing to incorporate lots of variables.”* The value, the participant said, is less in trying to get the scenarios right and more in preparing for a range of situations. *“For example, we had one scenario looking at the impact of Trump winning. And that scenario had the markets dropping 20%, etc. That was all wrong, but now we have gone through a scenario where if [the market does drop], we have prepared.”* Another said, *“There is value around those conversations and understanding where those levers are ... even if it doesn’t allow you to predict the future. Knowing the potential implications is vital.”*

One participant suggested today’s geopolitical risks are manageable: *“Undoubtedly there is more uncertainty on the political spectrum than there has been, but I don’t think it’s influencing people to fundamentally change their strategies. More likely people are just changing stuff on the edges. For example, the election of Trump is not going to make us conclude we should not do business in the United States. The sentiment he creates or the economic influences he may have may influence things, like, for example, is now the time to expand our consumer credit card business in the US?”*

“Our time is utterly dominated by regulatory change. There is no sense of stability in sight.”

– Participant

Expect more regulatory fragmentation

The implementation of regulatory reforms, concerns about regulations coming into effect in the next couple of years, and compliance issues continue to dominate board agendas. A participant stated, *“Our time is utterly dominated by regulatory change. There is no sense of stability in sight.”* Though some participants felt that the focus now is on implementation of regulations that have already come into effect, others noted changes that are still to come: *“GDPR, MiFiD II, PSD2, subsidiarization. Basel IV is coming. The changes to the risk weighting of assets could have a big impact.”*⁶

In addition, some expressed concern that the competition to attract financial services firms could result in regulatory balkanization: *“I worry about regulatory arbitrage ... I think there is potential for greater fragmentation. Do our paths diverge and the UK try to take advantage of Brexit by passing regulations, whether stronger or less strict? Or does the*

*UK focus on equivalence?” asked a director. But another insisted, “The politics are no different than they have always been.” This director pointed out that implementation of regulation and supervisory standards have always differed across Europe. The competition is not only between the soon-to-be independent United Kingdom and the EU, either. Writing in the *Financial Times*, an economist cautioned against a broader race to the bottom: “One can only hope that ... the wider competition between US and European banks, will not lead to another phase of financial deregulation.”⁷*

Regulators and banks are weighing the implications of subsidiarization

A 2014 report for the International Finance Corporation described how the focus on strengthening subsidiary governance came about:

In this highly unusual [2007] crisis, powerful parent banks were viewed as a potential source of risk to their subsidiaries, rather than the other way around ... Some subsidiary banks and host country supervisors found themselves in an uncomfortable situation as parents sought to shore up their balance sheets through intragroup transfers ... The broad thrust of the suggested remedies was to make subsidiary boards more attentive to the interests of the subsidiary and local stakeholders.⁸

The United States has required foreign banking organizations with non-branch assets of \$50 billion or more to establish a US intermediate holding company with an independent board of directors. The EU has proposed a similar requirement for foreign banks operating there. These requirements are intended to ensure that major operations of foreign banks have sufficient capital, liquidity, and accompanying governance.

A participant asserted, *“Politically aware regulators will reinforce subsidiaries.”* A regulator said it is not as simple as all regulators preferring more independent subsidiaries in their jurisdiction: *“There are some tactical decisions on what is better, a branch or a subsidiary. With a branch, there is some possibility of a problem back home not being able to support the branch. With a subsidiary, there is a chance you could be cut off and left for yourself. It is a much more complicated calculus than saying [that regulators] always prefer a subsidiary.”* The regulator said the decision to require a subsidiary takes into account factors such as assessment of the bank’s overall and local operations and risks, as well as the relative risks of taking on more responsibility for the entity: *“If we say we require a subsidiary, it provides a temptation for the home regulator to cut it loose if there is a real problem. With a branch, we need to decide if we are happy with allowing the branch and all the problems that presents*

“If we say we require a subsidiary, it provides a temptation for the home regulator to cut it loose if there is a real problem.”

– Regulator

because now the home country is not willing to drop it because of the integrated model.”

Several participants questioned the assumptions behind regulators’ focus on subsidiaries and the practical implications of that focus. One warned that strengthening the independence of subsidiaries would mean *“you will have less group support in a crisis. The groups dampened the [2008] crisis by putting capital and liquidity in from the group to support subsidiaries.”* Another suggested there would be *“greater risk in a ‘normal’ crisis that small subsidiaries might be abandoned.”*

Others do not believe groups would cut off subsidiaries so lightly. One noted, *“There would be real reputational damage if the group let a subsidiary go.”* But another participant said that in a serious enough crisis, reputational considerations might be overrun: *“Lehman, at the point of failure, didn’t care about their reputation anymore.”*

Global banking models are being challenged

Subsidiarization, turbulent geopolitical times, and technology transformation are putting additional pressure on bank business models already struggling to earn their cost of capital. European wholesale banking, in particular, faces competitive challenges from dominant US competitors and retail banks are particularly at risk for potential disruption.

A participant complained, *“It is increasingly difficult and costly to operate a global bank.”* Another observed, *“Finance, supply chains, and business models are all changing due to the retreat from globalization.”*

“With a ‘federal’ system [of banking], there are less benefits of scale.”

– Participant

Having to create independently capitalized and governed subsidiaries is causing banks to reconsider the value of international operations. A director said, *“Subsidiarization does impact core strategic decisions on where to operate. Or, in some cases, rather than questioning whether we should move some businesses, we are now questioning whether we should still do them at all. It puts on loose ground the whole concept of being a global bank.”* Another agreed: *“Given we don’t want to commit excess capital to subsidiaries, we are asking, ‘What businesses do we want to be in, and which do we want to abandon?’”*

Simplification makes scale increasingly important

One goal of regulatory reforms was to make banks simpler and large banks smaller. Subsidiarization pushes in the same direction. A participant observed, *“With a ‘federal’ system [of banking], there are less benefits of scale.”* Several participants support simplification: *“There are huge advantages to simplification of business models,”* one said. *“It allows us to think about what we will look like in five years’ time. There are diseconomies of complexity.”*

“The more standardized the business becomes, the more scale becomes important.”

– Director

But other forces are pushing banks toward greater scale. A participant observed, *“We’ve started just standardizing products ... We used to provide tailored solutions to clients. The regulatory framework no longer supports that—you will end up needing a thousand times the capital. We offer a standardized product.”* When products become standardized, they risk commoditization *“The more standardized the business becomes, the more scale becomes important. You can either ramp up market share or take more risk,”* said a director. Some banks may choose to ramp up international operations to compete in a *“global volume market.”*

Whatever the intent of policymakers, a participant noted, *“In reality, if you look at the league tables, the big are getting bigger. There are economies of scale in commodity businesses. That does not necessarily make the banks more complex.”*

European banks face stiff global competition

In wholesale markets, the “big getting bigger” are primarily US-headquartered banks. Many European competitors have retrenched, and some have shifted away from investment banking to focus more on wealth management or local retail banking. Some banking leaders have called for a European champion in investment banking. In 2015 both Société Générale CEO Frédéric Oudéa and Barclays chairman John MacFarlane were calling for a European champion to compete with US rivals. At the time, MacFarlane acknowledged the difficulties, saying, *“If you did want to create an investment banking champion for Europe, you would have to combine the investment banking arms of the main players, but you would have to swallow really hard and you would need political support.”*⁹

“Some of the banks are struggling to know what they should stand for.”

– Participant

In a conversation prior to the meeting, a participant said that European banks need to clarify their strategies before they consider mergers: *“The merger question is really difficult. Some of the banks are struggling to know what they should stand for. They are on different paths to recovery, but they have been trying to drive their return to profitability by cost cutting. What you don’t hear is, what do I stand for? Why is that important to my customer base? ... You have to know why you would consolidate with someone. Will it defend your geographic footprint? Will it allow you to compete with the US? How will it create a sustainable output in the future? People struggle with those questions.”*

In 2016, one commentator wrote, *“Many of the European banks that bulked up over the last few decades on Wall Street now stand at an existential crossroads. They are gazing at a future in which these businesses, even if they are able to make a profit, will probably struggle to cover their cost of capital in the foreseeable future.”*¹⁰ The commentator noted that the situation puts the European banks at a competitive disadvantage vis-à-vis US banks. The US market provides some structural

advantages that will be difficult for European banks to overcome. But, one participant noted, *“EU and UK banks have some comparative advantages: proximity to European clients, strong asset management and wealth businesses, strength in credit cards, which we export out of Europe, and the application of fintech in retail banking.”*

“Depending on how well EU markets implement PSD2, this cannot end well for some of the banks.”

– Participant

Banks must transform through technology to avoid becoming utilities

Returns at many banks have remained suppressed, and many remain focused on addressing their cost base. Some participants noted that we remain in a low-rate environment and predicted that when volatility picks up, the flow of business and net interest margins should increase. Others, however, remain concerned that *“[banks] have become utilities.”*

Competitive pressures from open banking

Beginning in January 2018, the Second Payment Services Directive (PSD2) requires banks in the EU and the United Kingdom to provide third-party access to current accounts via application programming interfaces (APIs). The UK approach, open banking, has been described as interpreting PSD2 “in the most adventurous terms, as an invitation to put in place the long-cherished plan of bank APIs with a universal standard.”¹¹ In the United States, some providers are volunteering to open up their systems to outside groups to develop complementary applications.¹²

There is concern, however, that open APIs let competitors take advantage of banks’ systems and data without the same limitations that regulated banks face. One participant observed, *“Some European markets are clearly overbanked. Depending on how well EU markets implement PSD2, this cannot end well for some of the banks.”* Another added, *“Fintechs see a real opportunity from PSD2.”*

“Bank as service can manage millions of customers very inexpensively.”

– Participant

As a result, bank boards are spending more time discussing the competitive and business model implications of financial technology and other technologies that can transform their institutions. A participant said, *“Fintech is changing the way in which business works. Banks have to transform their core businesses in a context that takes customers out of banks. We are empowering the customer so much. Information asymmetry is being hit big time.”*

The ability of third parties to access bank data and aggregate across financial institutions is renewing concerns about disintermediation from customers. And, noting the ability for fintech companies to use software on the cloud to efficiently offer modular banking platforms, a participant observed, *“Bank as service can manage millions of customers very inexpensively.”* In retail banking, new entrants face lower barriers to entry.

“There are plenty of opportunities ... You can be the aggregator. Build the platform and host other banks.”

– Participant

“It is a question of how clearly you can view your future.”

– Participant

A participant said, *“In retail, you can pick up 1 million customers with a tweet overnight.”*

The challenge is one the BGLN has discussed before: *“We are looking at a complete change of the core banking system. It is expensive, complex, and there is a very low payoff over the next three to five years,”* summarized one participant. Another said, *“It is difficult to have a long-term strategy for technology. It is moving so fast, you don’t have time to think.”* Yet, unless banks make an effort now, they will be left behind. *“In 10 years ... technology will change the world. PayPal took 20 years to get where it is today.”*

Reasons for optimism

An executive asked, *“Why are we so miserable? All of the banks represented around this table are stronger than we were. We all passed our stress tests. There are a series of positive indicators about the global economy.”* In response, one reiterated the challenges banks are still working through: *“We are spending a lot of time and effort just fighting to keep pace with what people are asking us to do. GDPR, PSD2, MiFID 2, etc. Everyone is working flat out to stand still, and there’s an exhaustion setting in I think, quite frankly. And every time you see the light at the end of the tunnel, someone builds on to the tunnel. And we’re not doing any of this to help the customers!”*

But others came back with reasons to stay positive: *“There are plenty of opportunities now in this banking environment. Innovation is needed. To me, some of these regulations, like PSD2, actually do provide some opportunities. You can be the aggregator. Build the platform and host other banks.”* One participant was positive about the future for wholesale banking: *“Tech is not really a disruptor in wholesale banking. We are the ones making the investments in technology. The barriers to entry and the money behind these businesses are just too great.”*

“I don’t think we’re all miserable,” asserted a director, *“What I’m hearing is a difference between the wholesale and retail, the simple and the complex. I think it’s really a challenging, but exciting, time to try to run faster than fintechs, to be more efficient. In running that race, we have a weight tied to our legs, which is regulation and complexity. But some of us are not miserable at all. It is a question of how clearly you can view your future.”*

The Bagehot column in the *Economist* recently stated, “The Brexit referendum has replaced moderation with polarisation and realism with ideology.”¹³ This shift is not unique to the United Kingdom. Political volatility is complicating the ability to predict the future of Europe, but political volatility is only one of the challenges the financial services sector must address. New regulations and ongoing pressures to improve returns persist. Global models are being challenged at the same time that global scale is more important than ever to compete in some businesses. Large banks are struggling to determine how they will compete in a world where many bank services could become commodities. They are seeking to cut costs by transforming their operations, and they hope to leverage technology to create new business opportunities—all while handling the continuing stream of political uncertainty, new regulations, and their usual range of compliance, operational, and strategic risks.

Appendix: discussion participants

On November 28, 2017 in London, Tapestry and EY hosted a BGLN meeting focused on the changing shape of international banking and the future of financial services in Europe. Insights from these discussions and additional bilateral conversations with directors, executives, regulators, and supervisors informed this *ViewPoints* and quotes from these discussions appear throughout.

The following individuals participated in these discussions:

BGLN Participants:

- Mike Ashley, Audit Committee Chair, Barclays
- Sheila Bair, Non-Executive Director, ICBC
- Win Bischoff, Chair of the Board, JPMorgan Securities
- Norman Blackwell, Chair of the Board and Nomination & Governance Committee Chair, Lloyds Banking Group
- Michel Demaré, Vice Chair of the Board, UBS
- Noreen Doyle, Chair of the Board, Credit Suisse International and Credit Suisse Securities (Europe) Limited
- Terri Duhon, Risk Committee Chair, Morgan Stanley International
- Mary Francis, Non-Executive Director, Barclays and Non-Executive Director, Swiss Re
- Jim Gollan, Chair of the Board, Bank of America Merrill Lynch International
- Jonathan Hill, former European Commissioner for Financial Stability, Financial Services and Capital Markets Union, European Commission
- Richard Meddings, Audit Committee Chair, Deutsche Bank
- Scott Moeller, Risk Committee Chair, JPMorgan Securities
- Roberto Nicastro, Former Chair, Italian “Good Banks,” Under BRRD Resolution
- Michael Percival, EMEA Head, Office of Regulatory Affairs, JPMorgan Chase
- Isabelle Romy, Non-Executive Director, UBS
- Mark Seligman, Non-Executive Director, RBS
- Alan Smith, Global Head, Risk Strategy, and Senior Executive Officer, Group Risk HSBC
- John Tattersall, Chair of the Board, UBS Limited
- Jasmine Whitbread, Brand, Value & Conduct Committee Chair, Standard Chartered

EY

- Marie-Laure Delarue, EMEIA FSO
Banking Capital Market Leader
- John Liver, Partner, FSO, EY
- Marcel van Loo, EMEIA FSO Regional
Managing Partner, EY

IGLN Participants

Dinner only

- Annette Andrews, Human Resources
Director, Lloyds of London
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Endnotes

¹ Kamal Ahmed, "[Bank of England Believes Brexit Could Cost 75,000 Finance Jobs.](#)" *BBC*, October 31, 2017.

² *Ibid.*

³ "[German Regulator Makes Flexible Pitch to Lure Banks After Brexit.](#)" *Irish Times*, January 9, 2018.

⁴ *Ibid.*

⁵ Eurasia Group, *Top Risks 2018* (New York: Eurasia Group, 2018), 19.

⁶ "GDPR" stands for General Data Protection Regulation; "MiFiD II" stands for Markets in Financial Instruments Directive II; "PSD2" stands for the Second Payment Services Directive. "Subsidiarization" refers to regulatory pressures to create more independent international subsidiaries of large financial institutions. Basel IV indicates the fourth iteration of the Basel Accords, developed by the Basel Committee on Banking Supervision.

⁷ Catherine Lubochinsky, "[France Balks at Reforms That Will Standardise Banking Rules.](#)" *Financial Times*, October 23, 2017.

⁸ W. Richard Frederick, *Challenges in Group Governance: The Governance of Cross-Border Bank Subsidiaries* (Washington, DC: International Finance Corporation, 2014), 1, 2.

⁹ Martin Arnold, "[Barclays Chief Says EU Banking Champion Needed to Compete with US.](#)" *Financial Times*, October 11, 2015.

¹⁰ Rob Cox, "[Mergers Could Help European Investment Banks Compete with the U.S.](#)," *New York Times*, DealBook, November 2, 2017.

¹¹ Rowland Manthorpe, "[To Change How You Use Money, Open Banking Must Break Rules.](#)" *Wired*, October 16, 2017.

¹² For more information, see Tapestry Networks, *Revolutionary Change Is Transforming the Financial Services Landscape. ViewPoints* (Waltham, MA: Tapestry Networks, 2016), 6, 10.

¹³ "[Walter Bagehot Would Have Loathed Government by Referendum.](#)" Bagehot, *Economist*, October 21, 2017.