

# Bank Governance Leadership Network ViewPoints

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## Leading the digital transformation of banking

“When I go to Silicon Valley...they all want to eat our lunch. Every single one of them is going to try.” – Jamie Dimon, Chairman and CEO of JPMorgan Chase<sup>1</sup>

The debate about the potential digital disruption of retail banking is an old one. In 1991, a study of the industry concluded that information technology (IT) in banking was creating value for consumers, but by intensifying competition and lowering barriers to entry, technology was destroying value for banks.<sup>2</sup> In 1994, Bill Gates referred to banks as “dinosaurs” and noted that people tended to overestimate the speed of digital transformation and to underestimate its ultimate impact.<sup>3</sup> More recent stories announce “The Rise of the Digital Bank”: Francisco Gonzalez, Chairman and CEO of BBVA, predicts that the next 20 years will see the world go from 20,000 “analogue” banks to no more than several dozen “digital” institutions.<sup>4</sup>

It is arguable that banks have long been at the forefront of integrating digital technologies into their businesses. As a BGLN director asserted last year, “Banks are the largest information companies in the world.” *The Economist* estimates that in 2013, banks spent \$180 billion on IT.<sup>5</sup> But digital technology has not yet transformed banking the way it has other industries, and banks have a reputation for being conservative and slow to innovate, especially in a world with increased regulatory constraints and a host of legacy issues still being addressed. According to one director, banks’ “*systems and processes look to be from the last century, or certainly from the last decade.*” At the same time, an executive noted, “*Banking has changed a lot: we have 24/7 banking, we can bank globally at any time online or via mobile apps. There has probably been more change than the industry gets credit for.*”

Over the first half of 2014, BGLN participants discussed the challenges and opportunities of digitization in banking, including two meetings, one on June 3 in New York and one on June 17 in London. Regulators, directors, and executives all concluded that digital transformation is now one of the most critical strategic issues for bank leaders. The competitive landscape could also be transformed by non-bank entrants, raising important questions for banks and regulators. The following key themes emerged and are expanded upon in this *ViewPoints*<sup>6</sup>, as are three questions for bank board consideration:

- **Digitization will truly transform banking**
- **Improving efficiency and effectiveness of processes and information technology is essential**
- **Bank leaders need to press for innovation and experimentation**
- **Regulation needs to keep pace with the rate of change**

## Digitization will truly transform banking

While a few participants questioned whether digitization was part of a gradual evolution, over the course of these BGLN discussions, many participants noted an increasing recognition that technology has reached a point where the industry could be transformed rapidly in the years ahead. As one executive acknowledged, *“The pace of change over the last couple of years has snuck up on us faster than expected.”* A director asserted that the world really is changing now, and if banks do not react, they could face a potentially existential threat: *“I am an evangelist for the belief that digitization will have a far-reaching and fundamental impact on banking. I worry more about changing organizations to adapt and survive than about the technology ... Some major players will become less relevant and not everyone will survive.”*

## Banks are not insulated from disruption

Mass digitization has transformed other industries, changing the relationship between companies and their customers. Digitally enabled distribution allowed companies like Amazon and Apple through its iTunes Store to interact with customers in a way that not only eliminated geographic distance between provider and customer, but also enabled a richer, two-way flow of information, that challenged “brick and mortar” retailing. Digital technology has enabled customers and producers to co-create, e.g. through things like Wikipedia, and “mashups,” web applications that use content from more than one source to create a single new service, rather than simply buy and sell more efficiently. The so-called “Internet of Things,” combined with social media analysis, is making massive amounts of data about consumers widely available. Economies of scale are changing in many industries. Mobile devices have been adopted and diffused faster than any technology in history,<sup>7</sup> changing the way people interact with each other and the way companies conduct business with their customers. These trends are increasingly prevalent in younger generations, who have never known any other way to interact with businesses, or financial institutions.

As Peter Sands, CEO of Standard Chartered, noted in an op-ed in the *Financial Times*, “Of course banks have invested huge sums in technology – automating processes and enabling customers to bank online – but we have not yet seen the fundamental transformation of business models that have taken place in other sectors, such as music. It will happen. And when it does, it will have a huge impact.”<sup>8</sup> The competitive landscape is changing as new and existing players adopt digital models. An executive stated, *“It is a fallacy that no one can disrupt financial services. The technology to build a better bank is getting easier. The Googles and Amazons, are well placed.”*

## Product and service models need to react to changing customer preferences and expectations

Customer expectations are increasingly being set by other companies, influencing how customers expect to interact with their banks. This is particularly true for younger generations: as one director observed, *“Millennials don’t ‘bank’ ... This is not just a technology question, this is about a cultural shift.”* Banks need to understand what their customers want and how their experiences with other companies are impacting expectations. One participant said, *“Where consumer standards are set by iTunes and*

*“It is a fallacy that no one can disrupt financial services. The technology to build a better bank is getting easier.”*  
– Executive

*Netflix – not by bank competitors – there are more expectations of integrated web, mobile, telephone, and in-person service.” Or, as another put it, “They want any channel, anytime, anywhere.”*

Participants see broader consumer trends with the potential to affect the banking industry: increasing segmentation between those looking for basic, easy-to-use products and services at low cost, and those looking for a high-touch, more tailored experience. Banks are beginning to ask questions like, *“Does the banking experience need to be as it is? Can it be more similar to engagement in other kinds of digital interactions?”* Some directors asserted that banks will have to fundamentally rethink their business models: *“We have to start where the customer is, not where the bank is.”* This thinking is leading to some experimentation, but bank leaders are also cautious about moving too far, too quickly, as discussed below.

### 1. How concerned should we be about new entrants?

New competitors are emerging, leveraging technology to offer products and services traditionally provided by banks. While some of these companies are household names and have already achieved significant scale (e.g., PayPal) or are large, non-financial online companies venturing into the financial services sector (e.g., Google), many of the companies hoping to challenge banks in their core services are still quite small. But new entrants have some distinct advantages. A participant noted that many, unsaddled by regulation, legacy systems, and bank cost structures, can *“run a low-cost business with radically different margins: One, by being direct, with no branches; two, by being simpler and more efficient; and three, not having a balance sheet.”* In addition, *“They can provide better customer service than banks, not by designing an amazing service, or training operatives to deliver ‘great service,’ but because their business model results in the perception of incredible service.”* BGLN participants highlighted potential challenges from new entrants:

- **Disintermediation from customers.** One director predicted challenges ahead: *“What you don’t yet see as much in banking, but you do in insurance, is marketplaces where you can pick up the cheapest prices based on specs. The traditional model where you go to the bank to get a banking product is unlikely to continue.”* In processing low-level payments, technology firms are not chasing a few cents of margin for each transaction, so much as hoping that *“the information that comes with such a payment might open up new sales and advertising opportunities that could be worth hundreds of times as much.”*<sup>9</sup> A subject-matter expert predicted that while banks may get transaction revenue, *“the information is gone because someone sits in between banks and the customer.”*

## 1. How concerned should we be about new entrants? *continued*

- **Erosion of margins in individual businesses.** Most participants do not expect new entrants to try to become banks; instead, one participant suggested, *“The threat to banks is in narrow bits of banking. [Non-bank technology companies] can do simple parts of banking better ... The potential for disruption in the market is an opportunity to steal customers by being better at serving them.”* Another participant shared a similar view, saying, *“It is not about recreating the universal bank, it is a question of what will happen to parts of the value chain ... It won’t be a head-on attack; it will be something that gives technology companies an advantage in their core business, with a financial services component.”*

### Do relationships with customers still matter?

A director asked, *“What is a brand in a digital world? That is a really important and difficult question for banks.”* According to one director, managing a digital bank brand means, *“We have to find the balance between developing a cool digital offering and basic trust and value for money.”* Trust remains an essential component of financial services brands, but the way that trust is built and maintained is changing. One participant noted, *“Who do customers trust? Peer-to-peer reviews are changing the nature of trust and banks have traditionally been based on face-to-face interaction.”*

Historically, banking was a regular interpersonal activity and customer attrition was low, in part because customers built relationships with their local bank and its bankers, in part because changing banks was difficult. An executive noted that those relationships often started with the first experience opening a bank account as a child, asking, *“How do you transfer the experience of engaging in a branch to online channels? How do we help people build a relationship with their bank?”*

One participant said banks should start by asking, *“What are the brand attributes you want, and what are the outcomes you are looking to achieve, e.g., efficiency for customers, or spending time to develop a real understanding of customer needs through discussion, a higher touch approach? How do you build a relationship both of you will find valuable?”* But others question whether customers still want relationships – as one participant quipped, *“Providers want relationships with customers; customers want freedom.”* As a result, another participant said, *“In a digital environment, it might be more important to build advocacy, because the use of reviews and social media can propagate.”*

As a result of changing customer preferences, participants highlighted two responses:

- **Building adaptable digital capabilities.** One director cautioned, *“The challenge is matching changes in consumer behavior across a spectrum of customers with the right pace of investment to match the economics. That is not easy to design from the inside.”* Because of the scale of investment required, and because, as another director pointed out, *“the agenda is moving so quickly and predicting what the customer will want in 10 years is impossible,”* bank leaders

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– Director

are cautious about overinvesting in the wrong places. The answer, according to one expert, is ensuring the investments are in technology that allows you to be *“digitized enough to be flexible fast,”* to be *“a fast follower, not necessarily a first mover.”*

- **Differentiating customer service.** Historically, a participant observed, *“Banks have done very little to tailor products. There is a lack of differentiation.”* Another stated, *“The customer experience has to change. Customers expect faster, but more personalized digital, multichannel service.”* Some participants claim regulation *“encourages uniformity and vanilla products,”* but others see increasing opportunity – and necessity – in creating distinctive experiences for customers. One executive said, *“It is a question of banking services vs. the product. In effect, the product is money. It is really about differentiating the service.”* Another suggested, *“It is actually easier to differentiate the experience for different segments digitally than physically.”* Some banks are identifying ways to play a larger role in customers’ transactions by providing more information and advice.

A participant emphasized, *“The way to build a brand is through fundamentally better service through people. If you focus on product, you take yourself into disintegration and potential disintermediation and specialization.”*

## 2. How should we balance investment in digital technology with sustaining our physical presence?

Industry experts have long predicted the end of conventional bank branches. Nonetheless, the number of branches in the United States and many European countries continued to grow until very recently.<sup>10</sup> Branches are expensive, accounting for about half the operating costs of large banks, but they have proven to be efficient investments.<sup>11</sup> However, the inflection point may have finally occurred. Branch numbers in the United States have gently declined since 2009.<sup>12</sup> Commenting on the economics of branch networks, one analyst said, *“It is bizarre how many branches there are ... If KKR [the US private equity group] were running Lloyds, I would bet my pension that it would have 30 per cent fewer branches.”*<sup>13</sup> Recent surveys show that *“18- to 29-year-olds in America choose their banks mainly on the basis of their online offerings,”*<sup>14</sup> and over 40% of people between 18 and 34 years old would switch to a bank without a physical branch network.<sup>15</sup>

Still, there are a number of forces at work in keeping branches open. There remains political and social pressure to keep branches open in many places, and some customers still rely on their local branch. In addition, some say the branches remain an important marketing tool and a statement about strength and stability. One executive said, *“A customer may never use the branch, but the reassurance that it is there is important.”*

## 2. How should we balance investment in digital technology with sustaining our physical presence? *continued*

Despite exponential increases in transactions done online, Wells Fargo recently stated that 85% of its products were still sold in branches.<sup>16</sup> As one director said, *“The cost of the technology and customer acquisition when you don’t have a physical presence is almost as high when you do, because you have to compensate for not having that physical visibility.”*

What the right balance will be is difficult to predict. Some of the justifications driving continued investment in branches may be based on false assumptions. For example, one executive noted, *“We actually see higher affinity ratings online than we do in the branches.”* Another executive said, *“All banks are experimenting with a smaller footprint, alternative locations, more functional ATMs, enhanced tablets, etc..”* Over time, the economics could shift enough that the investment of limited resources in branches increasingly comes at the expense of investing in new ways of interacting with customers.

### **Banks’ physical presence is changing, but won’t disappear**

Clearly, there is a trend toward reducing the number of branches as more customers move to online and mobile transactions, as noted above. But, participants agree that branches remain an important component of customer service and branding. As a result, they predict changes to the nature of branches, rather than a rapid decrease in their physical presence. Among the changes they expect, are the following:

- **Altering branch design.** If banks are going to retain a strong physical presence, a participant asserted, *“Branches will need to offer a completely different experience in order to survive.”* A director added, *“We are seeing a change in the nature of what the branch looks like: it’s a showroom for products and a place to talk with someone. It’s not a transaction point; it’s where searching on the Internet is too hard or the customer wants to have a specific conversation.”* Several banks are experimenting with new kinds of branches “that have chic lounges and edgy design that resemble the cool sleekness of an Apple store more than the beige walls and plastic-plant look of the past.”<sup>17</sup> Capital One, known primarily for credit cards, is expanding its physical presence and opening banking cafés in major US cities under the tagline “Let’s make banking history.”<sup>18</sup>
- **Changing staffing.** Banks are also retraining staff to provide more specialist advice. Barclays recently announced that they were getting rid of the bank cashier role altogether, retraining staff to train customers to navigate new technology.<sup>19</sup> An executive predicted, *“Not all customers are going to shift to becoming online-only customers – there are always customers that will benefit from human interaction and community involvement. As a bank, we need to sharpen those skills, and then open up our services to allow banking services to be accessed in different ways.”*

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– Director

### 3. Do we have the right people to drive the kind of strategic and technological transformation that is required?

In addition to retraining frontline staff, banks may need to think differently about the talent and resources they need to lead a transformation from an old-fashioned bricks and mortar bank to a modern, digital concept, from senior management down through the organization. Most bank executives and directors have grown up in banking and know the business as it has been, but not necessarily as it needs to be to compete in the future, nor are they always equipped to lead the kind of transformation that may be required. A director observed, *“The digital marketing capability and flexibility of key people within FIs will be tested and a lot of past experience will become irrelevant.”* Another shared a similar worry: *“A great concern to boards should be that senior executives do not fully grasp the extent of digital disruption that may be imminently facing their markets.”*

Bank leaders will need to consider whether they have the right teams in place for a shifting business model and ensure the culture in banks becomes more attractive to the kind of talent they will need in the future. Russell Reynolds, the executive search and consulting firm, states, *“Successful digital transformation is not merely a question of hiring a bunch of digital savants. A digital transformation necessarily impacts the entire organization, requiring leadership at multiple points across the enterprise.”*<sup>20</sup>

## Improving efficiency and effectiveness of processes and information technology is essential

The technology platforms in many banks are jokingly described as “spaghetti” – a mess of loosely integrated legacy systems, many still requiring manual interventions for data aggregation and analytics. Unlike the neatly layered architectures of more modern digital competitors, bank systems are often cobbled together after multiple mergers, integrations, and decades of patches. While some banks have invested heavily in improving the customer interface via digital channels, few have invested in the complete, end-to-end systems and processes. One director said, *“I am concerned about the fundamentally different cost base and structure needed, and the pace of change at which capabilities, processes, and core systems need to adapt.”*

### Three birds, one stone?

Digital investment can be leveraged to serve multiple needs that banks are facing, including: 1. Improving risk data management and responding to regulatory requests, 2. Increasing efficiency, and 3. Providing better customer service via digital channels. The challenge of dealing with legacy systems often comes to the fore in any talk of technology investment and improvements for the purposes outlined. A director commented, *“We spend a lot of time wrestling with our own octopus. We wouldn’t design the infrastructures we have today if we were starting fresh – the gap between what we have and what we would design is huge. Somehow, we need to run the business while unwinding that and creating something new.”* This is no small challenge.

Another director stated, *“I absolutely believe that the cost and process dynamics, and operational efficiency required to be successful in a predominantly digital world are of a different order of magnitude than what banks have thought about. Customer expectations (corporate, SMEs, retail) for speed, response, action, and feedback will be fundamentally different.”*

A director admitted, *“We tend to compartmentalize technology spending.”* Given the level of investment, of capital and time, needed to address a range of systems issues, such as updating legacy systems, responding to risk and regulatory reporting requirements, and improving data management, banks need to think more holistically about large-scale investments to systems that achieve multiple ends.

### Improving data analytics is a priority

Many banks look toward big data – a term broadly covering the software and human capability for screening large amounts of data for patterns or correlations – as the key to profiting from the massive amounts of information that they hold on their customers. Big data is nothing new for the banks; it has been used in credit scoring for many years. But insights from big data can be used to enhance customer targeting and advice and to adjust things like pricing and resource allocation in real time. These opportunities have not been fully exploited by banks. An executive said, *“The volume of bank data is a strength, but it can be used better, with more agility. The elephant in the room is the arrival of new entrants whose day job is analyzing data.”* A director added, *“We use data operationally, not strategically.”*

Participants point to three areas of focus for improving data management and analytics:

- **Integrating different sources of data.** Some participants question whether the data that banks have is as valuable as once thought in a world where so much information is accessible via social media and other online sources. As one director observed, *“The data we have is very transactional. We have a narrow view, we are not ‘context aware.’”* But the same director also noted the potential of new technology to build a more complete picture by integrating that transactional data with contextual data: *“With mobile, we have the potential to know how people are interacting with each other behind the transaction.”*
- **Investing in the capability to use the data effectively.** Banks have a unique view of their customers and yet many lack the data analytics capabilities to turn this into a competitive advantage and provide customers with more targeted offerings and solutions. A director said, *“We see more investment in filling the data box relative to the investment in the people to analyze it. Using the data to enable the parts of the business that interact with customers is quite difficult.”* Apps are being developed to quickly bring more information to the point of contact with customers by linking to bank databases, including a customer’s credit history, for example.<sup>21</sup>

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– Director

- **Improving customer service without violating privacy concerns.** Some participants raised questions about how far they can go in mining customer data. There is a need to ensure that customers see the use of their data as valuable and that their privacy has not been violated. A director said, *“The question is what should we do with the data? Customers believe vehemently that we shouldn’t use the data for advertising.”* Another participant echoed this concern, stating, *“We need to be incredibly careful. The customer’s relationship to money, to banks, is different than that which customers have with other companies. They trust the bank with the data to be provided advice, not to be marketed to.”*

### Bank leaders need to press for innovation and experimentation

A combination of cultural legacies and pressure from regulation and close supervision contributes to what some participants see as conservatism and caution in banks that can be slow to innovate. Boards may need to encourage more experimentation. A participant stated, *“This is a real threat ... Right now there are some geniuses in Silicon Valley sitting around thinking about how to beat us – and we’re not thinking about how to beat them.”*

But boards, too, are split on the relative scale and speed of change required. As one director said, *“Half of the people on the board think we are moving too slowly, the other half too quickly.”* Another director noted, *“The issues are not technical as much as they are organizational. We are talking about organizations that are incredibly resistant to change ... Boards should be focusing on how we make the organization more responsive, nimble, and customer-driven.”* Participants identified the following ways boards can engage in the digitization debate:

- **Ensuring strategic discussions about digital get due attention.** Not all boards have fully appreciated the scale of digitization as a core strategic issue, and therefore may not be spending enough time discussing the implications. One executive asserted, *“The business strategy risk is on the board agenda but they are not properly considering the specific risks of the consequences of being a digitized bank. The board is not yet aware of the dramatic transformational changes this will bring.”* A director agreed, saying, *“This issue has to move from the back-end in the IT department to the front-end of the CEO, risk committee, and board agenda.”* As boards increasingly shift away from a sometimes all-encompassing focus on risk and compliance issues, one director said, *“Now, we want to focus on the future, but how do you ensure it is safe?”* A shift in mindset may be required. One executive asked, *“What is governance in a digital space? How would Google, as a bank, be discussing this at the board?”*
- **Keeping the board updated and informed.** When asked if boards know enough about these issues to truly challenge management, several participants acknowledged they do not. While most directors agree that having members with a technology background is helpful, most said they would worry about relying too heavily on experts. Instead, they emphasize the need for management to provide enough background so the issues can be addressed by the board as

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– Executive

business issues. Still, an executive said, *“The pace of change is accelerating so fast, we need more connectivity from boards to what is really happening today.”*

Some participants have experimented with *“digital mentors”* from the bank’s digital unit to boost board members’ awareness. Others rely on informal input from younger professionals and even their children about emerging trends. Identifying ways to institutionalize those forms of input is a challenge, but the resources are available. One director explained, *“There are ways of engaging 25-year-olds in quite sophisticated ways and to bring in external perspectives ... I believe in the wisdom of the crowd. We employ a lot of people, and among them are those who know what is happening. They are the demographic.”*

- **Encouraging new approaches to innovation and partnerships.** Several participants agreed with one who suggested, *“Boards should be encouraging management to test, innovate, partner, and explore.”* This statement raises questions about the best approach to follow: *“Do you want to build something outside of the core infrastructure, an incubator for innovation? That has been proven to be less effective in some cases.”* A director pointed out that co-creation with customers is important, saying, *“We need our people working with customers on these things to understand what they want.”* Banks may need to increase partnerships to serve customers pervasively. A participant encouraged boards to press for experimentation of this kind, stating, *“Boards should demand laboratories to test hypotheses – it’s not a huge investment – and think more about processes. Ask how would we do this differently? It’s encouraging more innovative thought.”*
- **Balancing innovation with safety.** A regulator emphasized the benefits of digitization in meeting regulators’ objectives: *“The greatest innovation is simplicity. Banks can be less complex, better managed, and more resilient.”* But massive systems changes are not without risks. A director commented, *“Transforming systems will be one of the largest challenges, and economically undoable in some cases – it’s like heart and lung transplants in the 1930s.”* Another shared a similar perspective: *“Having omnichannels that have been built on legacy systems create five times the risk and complexity from before.”* A director stated, *“Aspects of security (cybersecurity and information security), information storage and capacity (capacity planning and peak usage), need to be in front of the CEO and risk committees.”*
- **Taking a long-term investment focus.** The board has a central role to play in guiding *“the timing and the investment risk you are willing to take.”* The board can steer *“investments needed in systems and reliability,”* not just in new customer interface. To achieve multiple long-term strategic objectives will require massive investments. A participant observed, *“Banks have made mostly defensive investments. They will have to consider big investments in the core banking platform. Then once you digitize the front-end, how do you take that through to an end-to-end process, digitizing infrastructure and becoming more fully integrated?”*

*“Boards should be encouraging management to test, innovate, partner and explore.”*

– Participant

## Regulation needs to keep pace with the rate of change

As bank business models shift and new, unregulated players emerge, key questions arise as to how regulation can and should respond. There are implications for prudential risk, conduct and consumer protection, and privacy and security. In some ways, regulation is a constraint against innovation for banks faced with new challenges from nimble technology companies and also a significant barrier for new entrants.

### Will regulatory scrutiny limit innovation in banking?

One director said, *“Building partnerships, innovation hubs, etc., takes a cowboy spirit, and I’m not sure people can do it with the current regulatory constraints. Banks would worry about regulators’ views.”* Indeed, another participant noted, *“Regulators are just that, regulators, not accelerators. They, by nature, do not like fast-moving, big changes in the industry.”* But a regulator said they do not oppose innovation, as long as it is innovation with controls, that there is *“demonstrated thinking among the board and management about how the risks are being controlled,”* adding, *“We are concerned with what is on the balance sheet, how much capital there is, how risk is being managed. We are indifferent as to the distribution channels.”* In fact, another regulator went further, saying, *“I would rather have the innovation in the confines of the banks where it can be supervised rather than within non-bank competitors.”* In the United States, the Federal Reserve has actually been pressing for improvements to the payments system to increase speed and uniformity.<sup>22</sup>

### What are the implications of digitization for conduct supervision and consumer protection?

One director said that banking *“will become a digital business with a physical presence in all aspects”* and that it has *“quite profound implications for conduct.”* Another added, *“Consumers are absorbing information from social media, online reviews, etc., all of which is informing their buying decisions. They want to do it quickly and they want it now – they expect five clicks to get them an answer, not 50 minutes. In that world, how do we ensure that they know, understand what they are buying?”* As several regulators have already suggested in prior BGLN discussions, banks can rely less on disclosures. Questions like, *“Can we rely on customers checking boxes online?”* can have profound implications for banks. Financial advice, another area of focus for consumer protection in recent years will also be impacted. A director observed, *“It is quite probable that the vast majority of financial advice going forward ... will be a combination of online delivery and person-to-person specialist advice that can be structured, recorded, and standardized. That could really mitigate conduct risk.”* But the same director continued, *“The regulatory regime will have to catch up with that and it will take some time.”*

If banks get better at mining data, it could be viewed with suspicion by regulators. Richard Cordray, director of the Consumer Financial Protection Bureau (CFPB), recently said they want to know *“if providers are using their data to target [low-income consumers] for higher-cost products, which would keep these consumers stuck in the same vicious cycle of tricks and traps.”*<sup>23</sup>

### How will regulation address non-bank competitors?

Some participants expressed concern that regulators do not seem to be giving due attention to what could be new sources of systemic risk, while many regulators note that their mandates are often limited to banks. A participant asserted, *“Regulators globally are lagging behind – it’s become a very large, non-regulated world and they don’t seem to be doing anything. If they go on ignoring it, it will be the next financial scandal because there could be deposits outside the guaranteed system and clients will be hit.”* Some technology companies are likely to avoid becoming banks as a result: *“Following the financial crisis, bank regulation has gone up a huge notch and I’m not sure many non-banks want to move into that world – it’s quite a barrier to entry for any core banking function,”* said one participant. As a result, it is not clear how regulators will intervene to supervise new entrants. The UK Financial Conduct Authority and the CFPB in the United States have broader mandates to address threats to consumers or market conduct, and groups like the Financial Stability Oversight Council can expand regulatory oversight to include non-bank companies. A participant said, *“If people outside of banking behave badly, regulation of them will inevitably increase.”* In general, participants suggest that regulators focus on the activities, rather than on the entities.

*“Regulators globally are lagging behind – it’s become a very large, non-regulated world and they don’t seem to be doing anything.”*  
– Participant

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Whether or not banking undergoes the kind of disruption that other industries have faced, it is clear a significant transformation is under way. While many emerging competitors remain small relative to large banks, the most disruptive technologies and strategies often appear as tiny clouds on an apparently calm horizon. The opportunity for banks with substantial, well-managed investment could be significant as some banks reduce costs and improve customer service, gaining market share by establishing themselves as leaders in digital banking. A director emphasized, *“This is not just about developing the new whizzy apps.”* This is about transforming businesses for future success, and boards have a major role to play in encouraging controlled innovation and long-term investment. The end result is likely to be a very different competitive landscape in banking, and one for which bank strategies and regulation need to adapt.

Although the conversations in New York and London were focused on consumer and business banking, the dilemmas and opportunities created by digital transformation affect wholesale bank operations as well. Future discussions in the Bank Governance Leadership Network will turn to the digital disruption of large-scale, wholesale businesses: services to large corporate customers, trading, and the like.

## About the Bank Governance Leadership Network (BGLN)

The BGLN addresses key issues facing complex global banks. Its primary focus is the non-executive director, but it also engages members of senior management, regulators, and other key stakeholders committed to outstanding governance and supervision in support of building strong, enduring, and trustworthy banking institutions. The BGLN is organized and led by Tapestry Networks, with the support of EY.

*ViewPoints* is produced by Tapestry Networks and aims to capture the essence of the BGLN discussion and associated research. Those who receive *ViewPoints* are encouraged to share it with others in their own networks. The more board members, senior management, advisers, and stakeholders who become engaged in this leading-edge dialogue, the more value will be created for all.

## About Tapestry Networks

Tapestry Networks is a privately held professional services firm. Its mission is to advance society's ability to govern and lead across the borders of sector, geography, and constituency. To do this, Tapestry forms multi-stakeholder collaborations that embrace the public and private sector, as well as civil society. The participants in these initiatives are leaders drawn from key stakeholder organizations who realize the status quo is neither desirable nor sustainable, and are seeking a goal that transcends their own interests and benefits everyone. Tapestry has used this approach to address critical and complex challenges in corporate governance, financial services, and healthcare.

## About EY

EY is a global leader in assurance, tax, transaction, and advisory services to the banking industry. The insights and quality services it delivers help build trust and confidence in the capital markets and in economies the world over. EY develops outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, EY plays a critical role in building a better working world for its people, for its clients and for its communities. EY supports the BGLN as part of its continuing commitment to board effectiveness and good governance in the financial services sector.

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## Appendix: Participants in BGLN digitization discussions

The following people participated in bilateral or group BGLN discussions on digitization in spring 2014, including two meetings of executives, non-executive directors, and supervisors, on June 3 and June 17, in New York and London, respectively:

- Giles Andrews, Chief Executive Officer, Zopa
- Marc Andries, Inspector, Head of Mission, ACPR
- Sandy Crombie, Senior Independent Director, Sustainability Committee Chair, Nominations Committee Member, Performance and Remuneration Committee Member, and Risk Committee Member, RBS
- Teri Currie, Group Head, Direct Channels, Marketing, Corporate Shared Services, and People Strategies, TD Bank
- Nick Donofrio, Non-Executive Director, Risk Committee Chair, Corporate Social Responsibility Committee Member, Executive Committee Member, and Technology Committee Member, BNY Mellon
- Susan Engel, Non-Executive Director, Credit Committee Member, Finance Committee Member, and Human Resources Committee Member, Wells Fargo
- Morten Friis, Non-Executive Director, Nominations Committee Member, Audit Committee Member, and Risk Committee Member, RBS
- Crawford Gillies, Non-Executive Director, Remuneration Committee Member, and Audit Committee Member, Barclays
- Colleen Goggins, Non-Executive Director and Risk Committee Member, TD Bank
- Stuart Haire, Managing Director, Direct Bank, Member of the Executive Group, RBS
- Mike Hawker, Non-Executive Director, Audit Committee Member, Governance and Compliance Committee Chair, and Risk Committee Member, and Nominating Committee Member, Macquarie
- Bob Herz, Non-Executive Director and Audit Committee Chair, Morgan Stanley
- Labe Jackson, Non-Executive Director, Audit Committee Chair, JPMorgan
- Olivia Kirtley, Non-Executive Director, Audit Committee Chair, Executive Committee Member, and Compensation and Human Resources Committee Member, US Bancorp
- Rachel Lomax, Non-Executive Director, Conduct and Values Committee Chair, Audit Committee Member, and Risk Committee Member, HSBC
- Linda Mantia, Executive Vice President, Cards and Payment Solutions, RBC
- Nathalie Rachou, Non-Executive Director and Audit, Internal Control and Risk Committee Member, Société Générale

**Participants *continued***

- David Roberts, Chairman Elect, Nationwide Building Society
- Anton van Rossum, Non-Executive Director and Risk Committee Member, Credit Suisse
- Jai Sooklal, Senior Vice President, Federal Reserve Bank of New York
- Sara Weller, Non-Executive Director, Remuneration Committee Member, and Risk Committee Member, Lloyds
- Anthony Wyand, Vice-Chairman of the Board, Audit, Internal Control and Risk Committee Chair, Nomination and Corporate Governance Committee Member, and Compensation Committee Member, Société Général; Corporate Governance, Human Resources and Nomination Committee Member, Internal Controls and Risks Committee Chair, Internal Controls Sub-Committee Chair, and Risks Sub-Committee Chair, UniCredit

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- David Deane, Leader, Digital Transformation
- Roger Park, Leader, Financial Services IT Advisory
- Ted Price, Advisor, Risk Governance
- Bill Schlich, Global Banking & Capital Markets Leader

**Tapestry Networks**

- Dennis Andrade, Principal
- Jonathan Day, Senior Advisor
- Charles Woolcott, Associate

## Endnotes

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- <sup>2</sup> Thomas D. Steiner and Diogo B. Teixeira, *Technology in Banking: Creating Value and Destroying Profits* (New York: Dow Jones-Irwin, 1990).
- <sup>3</sup> "[World, Here We Come.](#)" *Economist*, May 19, 2012.
- <sup>4</sup> Francisco Gonzalez, "[Banks Need to Take on Amazon and Google or Die.](#)" *Financial Times*, December, 2013.
- <sup>5</sup> "[Silver Linings: Banks Big and Small Are Embracing Cloud Computing.](#)" *Economist*, July 18, 2013.
- <sup>6</sup> *ViewPoints* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Italicized quotations reflect comments made in connection with the meeting by network members and other meeting participants.
- <sup>7</sup> Stephanie Mlot, "[Smartphone Adoption Rate Fastest in Tech History.](#)" *PC Magazine*, August 27, 2012.
- <sup>8</sup> Peter Sands, "[Banking Is Heading Towards Its Spotify Moment.](#)" *Financial Times*, June 30, 2013.
- <sup>9</sup> "[Retail Renaissance.](#)" *Economist*, May 17, 2012.
- <sup>10</sup> "[Withering Away.](#)" *Economist*, May 17, 2012.
- <sup>11</sup> [Ibid.](#)
- <sup>12</sup> Saabira Chaudhuri, "[U.S. Banks Prune More Branches.](#)" *Wall Street Journal*, January 27, 2014.
- <sup>13</sup> John Gapper, "[The Old Banks Are Returning but Without Their Managers.](#)" *Financial Times*, December 13, 2013.
- <sup>14</sup> "[Third Time Lucky.](#)" *Economist*, November 9, 2013.
- <sup>15</sup> Tom Braithwaite, "[Young People Open to Alternative Banking.](#)" *Financial Times*, May 26, 2014.
- <sup>16</sup> [Ibid.](#)
- <sup>17</sup> Constance Gustke, "[The Bank of the Future.](#)" CNBC.com, April 27, 2014.
- <sup>18</sup> <http://cafes.capitalone360.com/>
- <sup>19</sup> Sharlene Goff, "[iPad Generation Drives Banks' Shake-Up.](#)" *Financial Times*, July 11, 2014; Sharlene Goff, "[Barclays Scraps Bank Branch Cashier Role.](#)" *Financial Times*, July 11, 2014.
- <sup>20</sup> "[A Necessary Call to Action: Addressing the Digital Imperative.](#)" Russell Reynolds Associates.
- <sup>21</sup> Penny Crosman, "[What the IBM-Apple Deal Means for Banks.](#)" *American Banker*, July, 16, 2014.
- <sup>22</sup> John Gapper, "[US Banks Will Pay Dearly for Their Failure to Modernise.](#)" *Financial Times*, July 9, 2014.
- <sup>23</sup> Richard Cordray, "[Prepared Remarks of CFPB Director Richard Cordray at the Mobile Request for Information Field Hearing.](#)" Consumer Financial Protection Bureau, June 11, 2014.