



Emerging business models in banking

Bank Governance
Leadership Network

November 2019



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November 2019

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VIEWPOINTS

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I think it is still very much early days in terms of transitioning into some of these new models for incumbents. Legacy and transformation are still the focus. But the industry will evolve, and it will overhaul its value proposition in the coming years.

— Participant

Digital transformation efforts in banking are increasingly about rethinking longstanding approaches and expanding into new business offerings and models for delivering existing and new financial services. New models, such as platform banking and subscription-based models, and new data security services, have spurred speculation about the potential for banks to identify new sources of revenue and new ways of serving customers.

Questions persist regarding the scalability and sustainability of some of these models, and about the new entrants deploying them, yet the innovations in product and service delivery that are appearing across the ecosystem are already influencing traditional bank models. And although big tech players have not yet entered the industry as aggressively as some had expected, that may be changing. BGLN participants have taken note and are revisiting their own business models and strategies by entering new markets and business lines, introducing novel delivery channels, exploring more partnership opportunities, and leveraging technology in new ways that go beyond doing the same things faster and more efficiently.

On June 13 in New York and September 25 in London, BGLN participants met to discuss the potential for new business models to materialize in banking and related changes to operating models. The conversations covered the evolution from legacy models to new models, and the competitive landscape and expansion of partnerships.

This *ViewPoints* synthesizes the key themes which emerged from these discussions, and from conversations with network participants before and immediately after these meetings. The meetings also included discussions on innovative approaches to compliance. Themes from those parts of the discussions are summarized in a separate *ViewPoints*. This *ViewPoints* is

organized around the following sections:

- Transformation efforts and new possibilities
- Ongoing changes to the ecosystem

Transformation efforts and new possibilities

Though new applications of technology and a wave of new entrants have introduced novel possibilities to the industry, participants agreed that fundamental shifts in incumbent business models are unlikely to emerge at scale in the near term.

Firms are experimenting with new models

While fundamental changes to business models are unlikely, large banks are increasingly willing to explore new approaches. The nature of the financial services industry often means change occurs at a slow pace, but that does not mean fundamental shifts will never arrive. As a participant said, *“Is there going to be a Netflix or Uber moment in banking? Absolutely not. In banking it’s going to always be slow change over time. The fintechs and challengers are not going to take over the industry, and certainly not overnight. It’s going to be [a] slow transformation, but the slowness catches up.”* One director said, *“The large incumbents have been lulled into a false sense of security, because 10 years ago we considered fintechs a very scary thing and thought they were going to eat our lunch. Well, that didn’t happen fast enough, so now you have all these people very happily reinforcing their view that incumbents will maintain what they have and that’s a very risky thing to do.”*

Large banks are investing, with some annual technology budgets now in excess of \$10bn. As a director put it, *“We may have our legacy issues, but one advantage of scale is the benefit of investment. I haven’t come across any challenger that can do what a big bank can do, even though it may take us a bit longer to get there.”* Another director said, *“Big banks are slowly trying to move their spend away from running the bank to creating a new one. There is a general acknowledgement that they will be in dire competitive trouble if they do not make the investments. Banks want to free up as many innovation dollars as they can and try new things.”*

New markets and brands

Banks are selectively investing to expand into new business offerings and models for delivering core services. One example of a major initiative is Goldman Sachs’s launch of Marcus, an online platform that represented an entry into the consumer lending market. A participant said, *“I think Marcus*

“Is there going to be a Netflix or Uber moment in banking? Absolutely not ... It’s going to be [a] slow transformation, but the slowness catches up.”

— Participant

“The verdict is still out for these digital bank brands; results are mixed in terms of adoption and they still have to be aligned with your long-term strategy.”

— Participant

“My bank knows everything about me, but it knows nothing about me.”

— Participant

was a wake-up call for the industry; it forced everyone to think about how to digitize offerings and expand products.” In just over two years, Marcus, which expanded into the United Kingdom last year, has generated \$46 billion in deposits for Goldman.¹ Participants discussed the advantages of using a different brand, which can protect the core brand and quarantine risk. An EY subject matter adviser said, *“More firms are creating a digital sub-brand adjacent to the main brand. Marcus is one, but many others have emerged.”* This approach, however, has not been a guarantor of success. In June, JPMorgan scrapped its own digital banking app, Finn, which had been designed to attract younger customers, after just one year.² *“The verdict is still out for these digital bank brands; results are mixed in terms of adoption and they still have to be aligned with your long-term strategy as a firm,”* said a participant.

New ways to build customer trust and loyalty

Large incumbents maintain massive customer bases as well as advantages of scale. Many firms are focused on finding ways to leverage and maintain those customer relationships via technological improvements, better data management, and enhanced customer centricity and personalization. One director said, *“I think the opportunities for growth are not from platforming—you can just buy that technology or partner—I think it’s through opportunities to get more value out of the customer interface. And either you do that, or you lose it altogether.”*

Maintaining customer relationships and trust

Participants described the following trends:

- **Relationships, not transactions.** An executive said, *“A lot of banks say they have a relationship with the customer. But you still need to fill out all that information again to do a mortgage or get another product. That’s not a relationship, that’s a transaction. A relationship would be that you already know who I am.”* Many banks continue to struggle with aging legacy platforms, and the resulting poor data management continues to leave many firms without a single view of a customer. As one participant put it, *“My bank knows everything about me, but it knows nothing about me.”* Though improvements to infrastructure and onboarding processes have the potential to improve in this area, it remains a fundamental challenge for incumbents. An executive said, *“We talk about relationships; knowing our customers should be informing what we do as banks. Incumbents are wrapped up in what the fintechs and challengers are doing rather than what their customers are doing.”*

“Incumbents are wrapped up in what the fintechs and challengers are doing rather than what their customers are doing.”

— Executive

- **Data security, privacy, and trust.** In the current environment, companies that protect their customers’ data carefully will likely have an edge over the competition. Though banks have had reputational issues of their own, trust may still be an area where they have an advantage. Recent breaches, combined with a growing number of real and alleged misdeeds by several large technology and data companies have raised concerns among the general public around big tech. This may be an opportunity for banks. *“In banking, the important thing is trust. Trust is critical. The question is, can we catch up with the extremely rapid innovation occurring in the digital industry?”* a director asked.

Yet, some participants questioned the notion that banks have a trust advantage versus competitors. One director said, *“I’m not sure the general public is trusting of corporations broadly at the moment, and not of large banks in particular. I’m not sure the incumbents have covered themselves in glory from the trust perspective.”* The same director added, *“There is an inherent sense of safety and trust in size, but if some of the fintechs get large enough, things can change very quickly.”* It is also unclear how deep concerns about trust and privacy extend within the general public. A participant said, *“Amazon has much more information about me than banks do, and they know how to use it better. Of course, I trust them to provide me with better services.”*

Losing the customer interface: becoming the pipes

A persistent concern for banks is the risk of losing the direct interface with customers to fintechs and tech companies that can offer personalized engagement. A director said, *“There seems to be an assumption that banking will continue to be a vertically integrated industry. I wonder about that, because who will own the customer?”* The challenge of maintaining the customer relationship is sometimes linked to the “unbundling” of financial services, with customers increasingly willing to access different products and services from a range of providers rather than from a couple of large firms. A director asked, *“Do banks have a shot at owning the customer interface? Banks don’t rank the highest in customer relationships.”* Another participant observed, *“If you look at retail goods, is the profit made by the manufacturer or the retailer? Or asset managers or the distribution channels? You always go for the customer. It doesn’t have to be high cost, face-to-face. Amazon creates great value. The opportunities for growth aren’t coming from getting even smarter and lower cost, it’s getting more value out of the customer.”*

“The opportunities for growth aren’t coming from getting even smarter and lower cost, it’s getting more value out of the customer.”

— Participant

“There are some banks that see real opportunity in transaction banking ... Some call that becoming the ‘dumb’ pipes; I think the pipes are brilliant and there’s a lot of money to be made there.”

— Participant

While few banks talk openly about a willingness to serve as the product manufacturer or the “pipes” through which financial services are ultimately delivered by other providers, one participant said, *“There are some banks that see real opportunity in transaction banking, becoming that infrastructure. Some call that becoming the ‘dumb’ pipes; I think the pipes are brilliant and there’s a lot of money to be made there.”* Some smaller institutions have found success by creating a core business model around providing banking-as-a-service, white-label services, or back-end banking platforms for other merchants or providers. One such example would be Railsbank, an open banking and compliance platform that has positioned itself as “a utility for the complete financial services backend: platform, connectivity, operations, scheme memberships (e.g. Visa), regulation, and compliance,” according to the founder and CEO Nigel Verdon.³ Others include Cross River Bank and Bancorp. While one participant suggested some large banks might be forced to adopt such an approach, an EY adviser said, *“Most of the big banks are working on opening application programming interfaces to their partners, but not necessarily offering a full banking-as-a-service platform.”*

New products: could banks sell technology platforms?

Some financial services firms have started to offer proprietary operating platforms to other financial institutions, and with great success. Yet, while some questioned whether banks might follow a similar model, most participants remained skeptical about the prospect.

One example of this model is BlackRock, which has generated significant revenue in recent years from selling its Aladdin platform, originally an internal tool designed to help oversee risk and make investment decisions.⁴ It led to the creation of a new business unit within BlackRock that accounts for a significant portion of its revenue. An EY SMA stated, *“Aladdin has become the de facto platform for the industry and returns massive profits. The banking industry has the opportunity to do that. There seems to be a lot of thought that it cannot be done, but there is precedent out there.”*

Many large fintechs and tech companies have had similar success selling technology platforms, prompting some to question whether this might present an opportunity for large banks. Still, most participants did not see a major opportunity for banks selling proprietary technology. An executive explained, *“Let’s pretend we have something very cool and durable and we can package and sell it. Now you have to pay to keep that product going for a third-party need; that’s a lot of cost and effort that the returns likely won’t justify.”* Another participant agreed, adding, *“In my experience, it’s a*

distraction. It's very hard to package an internal product for external purposes. And then you need to service it. That requires a whole different structure."

Ongoing changes to the ecosystem

A growing mix of financial service providers and suppliers present banks with new opportunities to partner across the ecosystem.

"The perception of new entrants has really evolved. The 'buy versus build versus partner' decision paradigm is now very top of mind for all the big banks."

— Director

Partnership models are on the rise

Many financial services firms now talk of ecosystems, with multiple providers of different aspects of financial services partnering explicitly or networked implicitly, to provide the complete range of products and services to customers, rather than fully vertically integrated universal banks. Given the costs and time to develop new models and capabilities internally, many banks are increasingly open to partnerships among large financial institutions or with smaller fintechs and other technology providers. These partnerships are opening new opportunities, but also come with risks.

Evolving relationships

A director said, *"I think the debate has really opened up on the board in the last year or two. The perception of new entrants has really evolved. The 'buy versus build versus partner' decision paradigm is now very top of mind for all the big banks."* As the environment and perceptions have evolved, both banks and fintechs increasingly view each other as potential partners rather than competitors. A fintech executive explained their approach, *"The strategy was not to compete head to head with the banks; they have strong core competencies, strong brands, excellent risk assessment, and very low cost of capital. But there are areas where we can help them serve a different customer base or offer new technological capabilities."*

Though some have long predicted that big banks will focus on acquiring fintechs, participants saw this as unlikely: *"When you talk about acquisitions, that's starting to seem a bit more far afield at this point. Through partnerships, we can take advantage of their software or other capabilities, but you don't need to buy it because everyone else is going to have that technology in six months anyway."* For example, RBS reportedly considered an offer to acquire Monzo, the UK challenger bank, but found the valuation too high, opting instead to partner with another challenger bank to build a new platform.⁵

New possibilities and capabilities

“The business model is evolving away ... We are a relationship bank and the only way to do that going forward might be through partnering and outsourcing some of the relationship servicing.”

— Director

Established financial institutions have progressively displayed an openness to partnering with fintechs to provide their customers with enhanced digital offerings, explore new businesses, or reenter markets more efficiently than may have been possible in the past. Many fintechs acknowledge that their reliance on the banking system is not going away, and they see banks as important customers and sources of capital. A director explained, *“The business model is evolving away from the traditional. We are a relationship bank and the only way to do that going forward might be through partnering and outsourcing some of the relationship servicing.”* The ability to construct a bank is changing what is possible: *“You can outsource a lot of this stuff now, including things like platform technology or compliance. It’s enabling new possibilities, and it’s lowering the barrier to entry in a lot of ways,”* said an executive.

Careful partner selection

“As a fintech, you are either geared to work with the big banks or you’re not. It’s about building it from the ground up to be compliant and secure.”

— Executive

Working with new and different partners and vendors poses some challenges. An executive said banks must be careful when selecting firms to partner with: *“As a fintech, you are either geared to work with the big banks or you’re not. It’s about building it from the ground up to be compliant and secure—making sure the voices at the table represent the interests of compliance and security—and that it’s not an afterthought.”* As these relationships evolve, third-party risk management may be more vital than ever. However, most participants suggested the same third-party risk management and oversight should apply whether working with an established tech provider, a new tech provider or consultant, or a fintech. A director said, *“Big banks have worked with such a wide variety of providers over the years and understand that working with smaller or newer vendors is different from working with giant global ones. But it boils down to going through the right steps to assess the risks associated with that relationship.”*

Technology giants are moving into financial services

For years, bank leaders have been wary of the potential for technology giants to become direct competitors. However, to date, these firms have not entered banking as aggressively as some predicted. One participant suggested that factors limiting their expansion into financial services, at least in the United States, could be *“a fairly difficult regulatory environment and uncertainty about the direction the country will take in areas like open banking.”*

Some tech giants, like Amazon, count large financial institutions among their biggest customers, with many banks using Amazon Web Services or rival providers for cloud services. A participant observed, *“It may be that they see a more profitable proposition to having the US financial services industry as a customer instead of a competitor. Banks have a lot of legacy infrastructure to fix, and the technology giants are the only vendors who can do it.”*

But Facebook’s announcement of its plans to develop a digital wallet called Calibra, and ambitions to set up Libra, a digital currency that, if launched, could upend payments, and other more subtle moves by tech companies suggest that these companies may be reaching a turning point. A director observed, *“They haven’t done it yet because right now they’re doing very well and growing in other areas, but I think they will get to a point where entering financial services makes sense for them strategically. They want to own the markets.”* Participants also highlighted that some areas or services appear to be riper for disruption than others, specifically payments. One participant said, *“I think owning the merchants and keeping the customer captive in the broader ecosystem is their competitive advantage, particularly in payments because they have their platforms and so much data around the customers and merchants.”*

“In investment banking ... the lack of competition means they are not questioning their models enough compared to the retail space where there is a lot of soul searching.”

— Director

Digitization is changing businesses beyond retail banking

Much of the focus of discussions about innovation in banking and emerging technology competitors inevitably focuses on retail and consumer banking. A director observed, however, that *“even in investment banking, it’s increasingly about how you bring your platform data and services to make yourself a full-suite provider for investment banking. Interactions with your clients must be more digitally driven than ever before because more and more customers will demand it.”* Though the investment banking space has not seen the volume of new entrants and challengers that retail banking has, several participants highlighted the necessity to push forward with innovation. One director said, *“In investment banking, fintech really hasn’t been a threat yet. But the lack of competition means they are not questioning their models enough compared to the retail space where there is a lot of soul searching and introspection going on.”*

In wealth management, personal interactions remain a necessity according to several participants, suggesting it may remain more protected. A director noted, *“Most of these robo-advice platforms or purely digital services have not been very successful. Firms have found someone needs to be available*

to talk to because it's a scary space to be in as a consumer. It may not be relationships but rather human interaction that's necessary."

"In SME there are a few areas where digital can make a massive difference ... It used to be a monopoly by the incumbent banks; now, it's an opportunity."

— Director

The small-to-medium enterprise (SME) market is opening up

In corporate and commercial banking, large incumbents have long maintained an advantage given the high cost of operating, but large banks have also struggled with how to effectively and efficiently serve the SME market. An EY advisor said, *"There are real signs that things are changing in this space. SME might be the next big thing. In terms of attracting customers, the market is there."* A director agreed, adding, *"In SME there are a few areas where digital can make a massive difference. There's enormous value now for new players. It used to be a monopoly by the incumbent banks; now, it's an opportunity."* The sector has already displayed a number of new entrants like Kabbage, Funding Circle, and Oak North achieving rapid growth. Kabbage CEO Rob Frohwein explained, "Banks have underserved small businesses in need of \$250,000 or less for decades ... As a result, deserving small businesses have been left without the opportunity to access the capital required to grow their company."⁶ Further, an EY report stated that it is not only fintechs that are entering the space, as large technology companies are also making headway: "Technology firms are recognizing the challenges faced by small businesses in obtaining finance. Technology and e-commerce firms are using data to reinvent SME lending and disrupt the traditional business banking world."⁷

Consolidation is coming

Some have predicted a rapid increase in consolidation among smaller banks as a result of the need to rationalize branch networks and support investments in technology and innovation. The *Wall Street Journal* predicted, "The merger of BB&T and SunTrust could be the deal that opens the spigot."⁸ Several participants agreed that more consolidation will occur, including in Europe. A director said, *"It's going to happen. I think there has to be a trend toward consolidation. The need to get cost out is so great. Europe is the ripest place for it to happen because the outlook isn't particularly good there."* The trend may also come to fintech, said one executive: *"You do see more clear winners emerging over time, and that always provides opportunities for consolidation."*

"You do see more clear winners emerging over time, and that always provides opportunities for consolidation."

— Executive

Regulators are learning and adapting

New distribution models, the changing competitive environment, and developments in foreign markets test the ability of regulators to stay current

and respond to the changes in operating and business models. One regulator said, *“We’re learning like everyone else. The speed of everything has become so fast that we’re trying to understand things as they’re happening.”* A regulator highlighted the example of the platform models emerging in China, whereby tech companies serve as the primary intermediaries for payments and some other core financial services: *“I think all regulators need to get their heads around this future ecosystem. A report came out that states if you’re the owner of the platform you get 60% to 70% of the revenue. That changes the whole business of banking.”*

“It feels like we’re often dragging the regulators behind us. They need a greater vision and clarity of what they actually want.”

— Director

For big banks, regulators’ views on things like cloud computing and other innovative technologies will continue to play a major role in strategic planning. A few participants noted that regulators are catching up and, despite the common perception, are not generally a barrier to adopting new technologies. An executive said, *“We’re steadily and purposefully looking to move into the cloud. We’ve been challenged by regulators about our plans, but we’ve never been told we can’t do something if we can provide thoughtful and reasonable perspectives on why we’re doing it. There are obstacles to moving on from legacy and into the cloud, but for the most part, regulation is not one of those issues.”* However, one director suggested ongoing engagement would be necessary for regulators to keep pace with the changes in the sector: *“It feels like we’re often dragging the regulators behind us. They need a greater vision and clarity of what they actually want.”*

About this document

About *ViewPoints*

ViewPoints reflects the network's use of a modified version of the Chatham House Rule whereby names of network participants and their corporate or institutional affiliations are a matter of public record, but comments are not attributed to individuals, corporations, or institutions. Network participants' comments appear in italics.

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, members of 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 who seek 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 up 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: discussion participants

In June and September of this year, Tapestry and EY hosted two BGLN meetings on emerging business models and innovative approaches to compliance. These meetings included more than 35 conversations with directors, executives, regulators, supervisors, and other thought leaders. Insights from these discussions informed this *ViewPoints*, and unattributed quotes from these discussions appear throughout.

The following individuals participated in BGLN discussions on emerging business models and innovative approaches to compliance:

BGLN Participants

- Homaira Akbari, Non-Executive Director, Santander
- Jeremy Anderson, Audit Committee Chair, UBS AG
- Giles Andrews, Co-Founder and Non-Executive Director, Zopa and Chair of the Supervisory Board, Dynamic Credit
- Paola Bergamaschi-Broyd, BNY Mellon International Ltd
- Norman Blackwell, Chair of the Board, Lloyds Banking Group
- Pat Butler, Chair of the Board, Aldermore Bank
- Juan Colombás, Executive Director and Chief Operating Officer, Lloyds Banking Group
- Martha Cummings, Head, Compliance Strategy & Operations, Wells Fargo
- John Devine, Chair of the Board, Credit Suisse International
- Terri Duhon, Risk Committee Chair, Morgan Stanley International
- Julia Dunn, Chief Risk Officer, Nationwide Building Society
- John Johnston, Non-Executive Director, BNY Mellon International Ltd
- Phil Kenworthy, Non-Executive Director, ClearBank
- Kevin King, Head, Product Marketing, ID Analytics – Symantec
- Olivia Kirtley, Non-Executive Director, US Bancorp
- Beth Knickerbocker, Chief Innovation Officer, Office of the Comptroller of the Currency
- Stuart Lewis, Chief Risk Officer, Deutsche Bank
- Vishal Marria, CEO, Quantexa
- Tom Mildenhall, Global Head, Technology Business Development, Bank of America

- Scott Moeller, Risk Committee Chair, JPMorgan Securities
- Roberto Nicastro, Vice Chair and Risk Committee Chair, UBI Banca
- Yusuf Özdalga, Partner, QED Investors
- Andy Ozment, Chief Information Security Officer and Managing Director, Goldman Sachs
- James Paris, Chief Revenue Officer and Chief Strategy Officer, Amount
- Vandana Sharma, Senior Vice President, Large Institution Supervision, Federal Reserve Bank of New York
- David Sidwell, Vice Chair, Senior Independent Director, and Risk Committee Chair, UBS
- Alan Smith, Global Head, Risk Strategy, HSBC
- John Sun, Founder, President, and Chief Product Officer, Spring Labs
- Tim Tookey, Risk Committee Chair, Nationwide Building Society
- Radhika Venkatraman, CIO/CTO of Global Markets, Credit Suisse USA
- Tom Woods, Non-Executive Director, Bank of America

EY

- Omar Ali, Managing Partner, UK Financial Services
- Jan Bellens, Global Banking & Capital Markets Leader
- Kara Cauter, Partner, Financial Services Advisory
- Peter Davis, Americas Financial Services Advisory Leader
- Sara Elinson, Americas FinTech M&A Leader
- Ron Giammarco, Americas Financial Services Information Technology Advisory Partner
- David Kadio-Morokro, Americas Financial Services Advisory Deputy Innovation Leader
- Marcel van Loo, EMEA Financial Services Regional Managing Partner

Tapestry Networks

- Dennis Andrade, Partner
- Brennan Kerrigan, Associate
- Tucker Nielsen, Principal

Endnotes

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