Innovation in banking and the changing financial services policy landscape

Bank Governance Leadership Network

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> *The hardest judgment is, are we doing enough, going fast enough, and what is possible?*
>
> – Bank Director

Innovation, disruption, digitization, technologically driven transformation – these are the buzzwords of the day in every industry, but especially in financial services and banking. The scale and pace of technological advancement, the need to address efficiency and adapt business models, and the emergence of fintech competitors and partners make innovation a necessity if banks are to keep pace with changing customer expectations and behaviors.

Some critics suggest that little has changed in banking. A bank director at last year's Financial Services Leadership Summit decried the bureaucratic hassle that his own institution had required simply to increase a credit line. A prominent list of the world's 50 most innovative companies includes exactly one bank, JP Morgan Chase.[1] Yet large banks are trying hard to innovate. Most have rapidly adopted online and mobile banking applications for example, and banks are among the leading investors in financial technology. Banks should have a good platform that mitigates the risk of competitive disruption: among other advantages, they have enormous scale and virtually every individual or business needs at least basic functions that banks are uniquely positioned to provide. It has been no easy task, therefore, for boards to determine where true innovation is most likely to disrupt traditional business models, where it is most needed to stay competitive, and how best to work with management to prioritize investment.

Just as the technological and competitive landscape is changing, there is potential for significant change in financial services and regulatory policy in the United States and internationally. Policymakers are considering changes that would have significant implications for banks and regulators, and supervisors are developing approaches that balance the benefits of innovation with the safety and soundness of large financial institutions and the system. Major legislative changes are possible, though perhaps unlikely, but leadership changes at major US and international regulatory authorities are a certainty.

Over the course of several months, culminating with a meeting on June 8 in New York, Bank Governance Leadership Network (BGLN) participants shared perspectives on the innovation agenda, as well as the changing US policy landscape and its implications for large banks. This *ViewPoints*[2] synthesizes the perspectives and ideas raised in the meeting, as well as in nearly 30 additional conversations with directors, executives, supervisors, and banking professionals. A list of individuals who participated in discussions can be found in Appendix 1. The discussions yielded themes and insights of note, summarized in the following sections:

- **Strategy must drive the focus and scale of innovation efforts**
- **Enabling innovation requires changes to organization structures, cultures, and people**
- **Changes to regulatory policy are likely, but the nature and extent of those changes remain unclear**

Strategy must drive the focus and scale of innovation efforts

While many speak of the sustained efforts of banks to innovate, most participants suggest that they have been focused for so long on survival and on risk management, that, as one said last year, *"Banks haven't really been able to pivot to innovation, maybe until now."* More recently, Brian Caplen, editor of *The Banker*, wrote, "In reacting to the digital threat, many companies – banks included – have merely overlaid online services over a legacy process. This failure to restructure is the reason why the new technology has not boosted productivity … But all this is about to change. We are on the verge of an epoch-making era when core industries and businesses go digital and transform society."[3] As a result, innovation has become more than a buzzword for bank boards. *"Two or three years ago, it was just a lot of broad talk about innovation. Now there is much more interest in systematic investigation and selection of the technologies that will really make a difference,"* said a director.

"It is about setting priorities. There is no end to the areas where we could invest capital in terms of demand."

– Participant

Creating a roadmap to navigate the innovation agenda

While recent years have seen hype around fintech companies disrupting banking, the conversation has recently concluded that large incumbent banks have many advantages over start-ups –customers, data, and capital. These are extremely difficult to replicate, and forward-looking banks can acquire companies and technologies, or partner with companies, that create truly innovative approaches. Yet some participants warned that *"15,000 competitors biting at your ankles"* could present an equally worrying competitive threat as large fintech firms. Many analysts suggest that the greatest threat to big banks is the expansion of financial services from major technology firms like Facebook or Amazon,[4] who can rapidly roll out new financial offerings to billions of customers, leveraging vast reserves of data. All of this contributes to the challenge for boards in determining how much innovation is needed to remain competitive.

Participants identified the following activities as key to navigating the innovation agenda:

- **Linking innovation to firm strategy.** Setting the innovation agenda comes down to linking investment to strategic priorities. One participant stated, *"It is the same issue we face in all areas of the business. It is about setting priorities. There is no end to the areas where we could invest capital in terms of demand. So the question is, which part of the octopus do you focus on?"* Another added, *"The highest strategic priorities need to get the most attention. You see where there are constraints, and you have to identify ways to remove them, but also keep people excited."* One of the biggest challenges regarding innovation is that it is nonlinear: disruption can happen suddenly. One participant remarked, *"Once you reach the tipping point, you are too late."* Tying innovation strategy to a typical three- to five-year strategic planning process could therefore be counterproductive. The pace of technological change requires frequent course corrections. Yet a giant bank cannot pivot with the speed of a 50-employee startup.

"The time and effort spent on what people think is innovation is actually just catching up with the past."

– Participant

- **Articulating an innovation strategy.** A director asked, *"It is one thing to develop a couple of bespoke solutions, but how do you fit them all together? What conversations are happening at the board on broad innovation at the firm rather than about specific activities or initiatives?"* Participants admitted that much of what is talked about in the context of innovation in many banks is about improving efficiency as opposed to real business model innovation or transformative process improvement: *"A lot of the talk isn't about real innovation, but using technology to do the same old things, to replace manual functions or make marginal improvements. The time and effort spent on what people think is innovation is actually just catching up with the past,"* observed one participant. Another warned that much of what banks call innovation will therefore quickly become *"table stakes,"* that is, requirements to stay in business as a bank. Most agreed with a director who asserted, *"For the board, the question is how do you differentiate?"*

  In order to better understand the objectives of innovation efforts, some participants called for boards to better understand and articulate their banks' innovation strategies. One director said, *"Disruptive change is going to happen; the only relevant question is where you are when it does, and what your strategy is. Can you as a director understand and articulate that? Can you be comfortable when other firms get out in front of you?"* This director added, *"In some people's minds there is always time to keep up. They say, 'I don't need to be first' – and that's fine. The question is, what is your appetite for being a category definer? Or do you want to be a fast follower? You need to know what your point of view is on this. If you don't know these things, you're probably in trouble."* Yet, another also cautioned about the need for vigilance: *"Nokia had a five-year innovation plan, too. How do you make sure that you don't miss the boat? You don't see it coming, then it's too late."*

"The question is, what is your appetite for being a category definer? Or do you want to be a fast follower? You need to know what your point of view is."

– Director

- **Focusing on scalability and execution.** A participant observed, *"So much of this technology will change the entire financial services model – but everyone will have access to these technologies, so the technology itself will not change the competitive landscape."* Therefore, according to this participant, *"It will be your execution of these technologies as a firm that will matter."* Another participant emphasized the ability to apply novel approaches at scale, saying, *"The key is, once they create that great idea, how do you then morph it into something scalable? That is the real question. The winner is going to be not just someone who strikes on a good idea, but who is able to quickly scale and operationalize some of the innovative approaches being tested on the margins."*

"The winner is going to be someone … who is able to quickly scale and operationalize innovative approaches being tested on the margins."

-Participant

Enabling innovation requires changes to organization structures, cultures, and people

Innovation in large banks faces a number of structural and cultural obstacles. A large diversified bank cannot function like a lean tech start-up, nor should one try. As one participant noted, *"The reality is that there is no room for fail fast at a big bank. It is just not possible today."* Banks' necessary focus on compliance and risk avoidance can dampen the entrepreneurial cultures that tend to spawn real innovation. One banking expert went as far as to say, "Banking and innovation doesn't go together. Innovation creates risk and risk is unacceptable in a financial marketplace. That is why it is difficult to get new things started. We don't want to start new things. We want things just the way they are: manageable, predictable and boring."[5] Yet, some participants see a need for fresh thinking. One stated, *"The winner may not even exist today. The winning organization is likely those that play around, where failure is embraced. Those that keep doing the same thing won't succeed."*

Finding the balance between innovation and control

Operating in a highly regulated industry can hinder the development of a grassroots culture of innovation. One participant commented, *"There is a conflict between a culture of innovation that allows failure, where you take bets, versus all the preaching in banking about a culture of zero tolerance on compliance. There is an in-house tension. How do you deal with it?"* While most participants have witnessed improvement in control structures in recent years, some regulators are still concerned that the right controls are not being put in place, especially for customer-facing technology. In a conversation last year, a supervisor observed, *"There are places where we've seen banks embrace technology in their business lines as revenue-generating without sufficient thought on how to control it. Whenever we see banks integrating new technology, we have an expectation that they implement controls at the same time. You don't always see that happen as seamlessly when technology is at the heart of the matter."* A participant summarized the questions for board risk and audit committees: *"Are your controls developing in tandem, at the appropriate level, with innovation? You don't want to slow down innovation, but you need a proper control and risk environment."*

"There is a conflict between a culture of innovation that allows failure … versus all the preaching in banking about a culture of zero tolerance on compliance."

– Participant

So how do banks find the balance? A director cautioned, *"Fintech is not the analogy,"* since in these firms failure is not only tolerated but encouraged, and brands and companies can come and go. Instead, this participant suggested, *"The comparison is Apple and Facebook. They are large companies that constantly launch products that fail, but the brand protects it. The product fails, but the company is unaffected."* Another participant suggested banks are under a level of scrutiny that is different than virtually any other sector and therefore don't have the luxury of even minor glitches: *"If there is an outage, I reckon we have 30 minutes before the national regulator is on us and an hour before we're on the cover of the newspaper."* Concerns about operational and compliance risks associated with technology transformation mean that bank leaders must assess the benefits of digitization against the potential risk, such as service disruptions that could have damaging reputational effects on a bank whose customers expect uninterrupted, 24/7 access. As one director quipped, *"Digital is not cheap if you anger 25 million customers."*

"Digital is not cheap if you anger 25 million customers."

– Director

Identifying objectives and measuring progress

A participant said, *"I'm curious as to the most effective role for the board in overseeing technology and innovation. What should we measure? What should we expect from management? How do we work with them better?"* Participants suggested that boards can bring more rigor and structure to oversight of innovation, just as they do in management of market and credit risk. That includes more clearly defined goals against which progress can be measured: *"How are we defining our objectives? Some need to be focused on performance. Some need to be focused on optimization. Some will focus on reimagining the whole customer experience,"* said a participant. Metrics on progress and effectiveness of innovation efforts include survey data on the customer experience, increases in digital sales over time, the volume and nature of financial transactions in the branch, digital adoption by customers, and changes in productivity.

Even as boards consider improvements to internal metrics, many participants acknowledged that it is difficult to benchmark with peer institutions. One director stressed, *"We have to have innovation – it is mission critical. But how do you know if you are best in class in a category or that you are not lagging behind the industry or peers in many of these areas?"* Many banks talk of the balance between run-the-bank technology spending and spending focused on innovation. For example, in his annual letter to shareholders, JPMorgan Chase Chairman and CEO Jamie Dimon said that of the more than \$9.5 billion the bank spent on technology in 2016, approximately \$3 billion was dedicated to new initiatives, including approximately \$600 million for emerging fintech solutions.[6] Royal Bank of Canada CEO David McKay suggested his bank was aiming to bring its innovation spending, which includes AI and blockchain, up to at least 40% of its overall technology budget.[7]

"How do you know if you are best in class in a category or that you are not lagging behind the industry or peers in many of these areas?"

– Director

But these metrics are not uniform, and it can be difficult to determine how much is really devoted to innovation. One participant explained, *"It is difficult to generalize technology spending across large banks. Most CEOs are talking about their digital spend, but the numbers are all over the place because it is all measured differently. It is not a GAAP* [generally accepted accounting principles] *measure. That is why the range is so startling* *and the market goes crazy in response to these numbers. In the aggregate, it is an important indicator, but it is really happening at the micro level. You need to look at the different business lines."* Outside of the sector, comparisons are even more difficult: a participant asked, *"Are we underinvesting in innovation relative to other industries? The pace of change is quicker than in some other industries and the permission to take risks is greater outside of banking."*

Updating board governance of innovation

BGLN participants have debated how to strengthen board composition in the context of a rapidly changing technological and competitive environment. They note the importance of finding new ways to meet the challenge – creating technology and innovation committees, for example; or increasing the use of external advisors; or adding "digital directors" with technology expertise. Yet bank boards continue to be criticized for being slow to adopt a more tech-centric approach to strategy, management, and governance. Chris Skinner, a prominent financial technology commentator, recently wrote, "Banks are led by bankers, but banks are fintech firms too. Banks should therefore have a good balance of technologists and bankers in the boardroom. If a bank's leadership team cannot understand the difference between machine learning and deep learning or between blockchain and a distributed ledger, how can they possibly lead the bank into this digital future?"[8] In recent conversations, participants cited the following efforts as worthy of consideration:

"If you say technology is in everything you do, then do you have a technology committee?"

– Participant

- **Revisiting board and committee structures.** Innovation and technology have often been treated as issues separate from core board strategy and risk oversight, but they are increasingly central to all aspects of banking. This raises practical questions for how boards should structure themselves to effectively oversee the innovation agenda. One participant asked, *"If you say technology is in everything you do, then do you have a technology committee?"* Others agreed that when technology is central to a board's agenda, a single dedicated committee may not make sense. Worse, a technology committee could lead other directors to shirk their own responsibilities for staying abreast of critical technical developments. But several participants said that these committees can provide focus and act as an advocate for the innovation agenda with the full board, in the same way that audit and risk committees do for risk, compliance, and financial reporting. All agreed that the overall agenda needs to be owned by the full board.
- **Updating director competencies over time**. Most directors continue to caution against increasing specialization on boards, including recruitment of a technology expert. Nonetheless, boards are thinking differently about the experience and skills of new directors. One participant said, *"Do we need a law that says every board needs a Jeff Bezos on it? No. They would add value, but we should not come to the conclusion that boards can't oversee innovation processes without these types. If as a board you agree to metrics that matter, then smart board members can track and ask the right questions."* However, participants accept that the skills and experience they are prioritizing in new director candidates suggests a

natural evolution of the board over time. As one director summarized, *"Do I think the competencies from 10 years ago are the same today? Probably not. We are looking at every board candidate and asking, were they in a business that was challenged digitally by technology? Have they led transformations?"*

"We are looking at every board candidate and asking, were they in a business that was challenged digitally by technology? Have they led trans-formations?"

– Director

A director suggested that bank boards could benefit from approaching technology and innovation more like a technology company does: *"At a tech company, we talk about technology in a different way. Technology is our product or service, so the focus is on revenue generation and creating markets. It is not like banking, when you call out, 'Now we are talking about digital innovation.' For technology firms, it is omnipresent. This is probably something that needs to shift inside the bank boardroom."*

Determining the most effective organization structures to encourage innovation

Some research indicates that in order to innovate, banks should not mimic start-ups – sitting in a room brainstorming ways to launch a completely novel product – but should instead focus on improving agility so that teams can act more quickly on customer insights, react to market developments and radically improve service.[9] Bank leaders are experimenting with approaches to enable targeted innovation in the context of a regulated bank:

- **Drive innovation from the front lines.** Some say that innovation has to come from the front lines to be driven from the grassroots up. A participant commented, *"One of the most important aspects of innovation is how to organize. A key principle is that transformation has to be business-led."* The most effective innovations often emerge from employees interacting directly with customers and thus gaining a strong understanding of changing customer needs and expectations. *"There is an opportunity to let teams who are connected to the customer solve problems. It will be an opportunity to differentiate. You need to be responsive to the most immediate pain points,"* said another participant.
- **Keep innovation at arm's length from the business.** Even though bank leaders see that important innovations emerge at the customer interface, most have launched separate innovation centers in one form or another. Advocates argue that typical bank structures and processes impede innovation. A participant observed, *"Innovation doesn't need to happen in the boardroom. Innovation can happen in the technology lab in the basement or off-site, where you can let people wear their sandals and jeans."*
- **Create integrated innovation teams.** Some banks have established integrated teams that bring different functions together to focus on innovation. This allows for functions that may not often collaborate to work together, so that people from the businesses, who can identify challenges and possible solutions, team up with those who understand technology's possibilities and limitations and may be familiar with emerging approaches. As one participant noted, *"It is very difficult to drive innovation only with bankers or only with digital experts. You need both. Someone from a bank background can sprint for the first few months, but they will miss the big innovation.*

"It is very difficult to drive innovation only with bankers or only with digital experts. You need both."

– Participant

The digital expert will struggle to push the business. Get them to work together on projects to create more velocity and agility." According to one participant, *"Organizing innovation or digital above the businesses is the riskiest approach. You need buy-in."*

- **Partner with fintechs and acquire technology.** Banks are also considering the balance between building in-house innovation expertise versus partnering and acquiring technology or start-ups. Several participants noted a softening of the competitive, zero-sum mentality among leading banks when it comes to the pursuit of certain kinds of innovation. Many firms are entering into new business models by partnering with start-ups and even working across the sector to share costs and resources on mutually beneficial initiatives.

Reimagining branches

Banks' physical presence is changing. There is a clear trend toward reducing the number of branches, as more customers move to online and mobile transactions.[10] Where at one time experts predicted the demise of the bank branch, most BGLN participants now insist that branches remain an important component of customer service and branding, and that they will change in nature rather than disappearing. A participant said, *"What do digital natives lack that we have? Branches. Can we rework them in a way that is compatible with the digital experience?"* If banks are to retain a major physical presence, a participant asserted, *"Branches will need to offer a completely different experience."*

Innovative banks are looking to models outside the industry for inspiration. A participant observed, *"I admire how Apple changed their model. They used to use Apple Stores for sales, but now their business is mainly e-commerce. The stores are now used mainly for digital training, to offer advice, and to give free training."* This participant continued within the context of banking, stating, *"The utility of the branch is definitely changing. Customers still think banking is very complicated. The challenge is defining what we want to do with this opportunity rather than view it as a challenge. Branches can be useful customer service and training points."* In recent years, several banks have experimented with "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."[11] Capital One, traditionally known primarily for credit cards, is gaining notoriety for expanding its physical presence and opening banking cafes in major US cities under the tagline "Let's make banking history."[12]

> *"The utility of the branch is definitely changing … The challenge is defining what we want to do with this opportunity rather than view it as a challenge."*
>
> – Participant

In the end, participants acknowledged that banks are running a wide range of experiments: investing directly in fintech start-ups, acquiring financial technology, partnering with financial institutions, and developing proprietary approaches internally. As one participant highlighted, *"The key question is, do I have a critical mass of innovators in-house so that these ideas are coming through?"*

Not just changing talent, but embracing new mental models

Over many years, BGLN conversations have discussed the importance of incorporating new talent to push the digital agenda, while still taking advantage of the experience and knowledge of current employees. Some participants suggested there is a continuing need to replenish talent pools. One participant said, *"The pace of the world is changing, and expectations of customers are fundamentally changing, which compels you to reinvent yourself at breakneck speed."* One participant called for financial services to consider talent management models of leading professional services firms, where a quicker rate of hiring and departures can create a constant flow of fresh talent and thinking.

Even as banks continue to rethink their talent needs, some innovation leaders are calling for deeper cultural shifts. GE Chairman and Chief Executive Jeff Immelt said, "This is something that I got wrong. I thought it was all about technology. I thought if we hired a couple thousand technology people, if we upgraded our software, things like that, that was it. I was wrong. Product managers have to be different; salespeople have to be different; on-site support has to be different. We've had to drill and change a lot about the company."[13]

"There are signs the regulatory philosophy is changing. Nobody wants to go back to 2007, but we are at a point of diminishing returns and opportunity costs."

– Participant

Changes to regulatory policy are likely, but the nature and extent of those changes remain unclear

At a panel at the 2017 annual meeting of the World Economic Forum, Deutsche Bank CEO John Cryan commented, "As regulation becomes more granular, traditional institutions tend to become less innovative and we're looking elsewhere for disrupters. Everything regulated tends to continue as it is. Regulation is not generally a facilitator of change."[14] BGLN participants have cited increased regulation and regulatory uncertainty as significant inhibitors to fully embracing innovation. However, recent developments suggest that the regulatory landscape could soon see significant changes, particularly in the United States, where the Trump administration and other political leaders are suggesting major changes to regulations and the roles of key regulatory authorities. At the same time, regulatory authorities around the world are considering how to enable innovation in financial services and, simultaneously, how to prevent the expanding range of providers, including tech companies and fintech firms, from putting customers or the system at risk. As one participant summarized, *"I don't see these two trends as mutually exclusive. There may be an overriding theme of less regulation, but there may be some who see an advantage to operating within the regulatory framework like fintech firms. They may coexist."*

Sweeping legislative changes are unlikely, but significant shifts are possible in regulatory approaches

The new administration has made clear that it aims to reduce regulation and roll back reforms enacted after the financial crisis. As one participant highlighted, *"There are signs the regulatory philosophy is changing. Nobody wants to go back to 2007, but we are at a point of diminishing returns and opportunity costs."* Another added, *"We are at an* *inflection point. There will possibly be less new regulatory initiative requirements and more time to think about innovation."*

In recent weeks, much attention has focused on the House of Representatives' vote to replace and significantly modify elements of the Dodd-Frank Act.[15] Leading the charge is Republican Representative Jeb Hensarling, whose Financial Choice Act promises regulatory relief in return for banks holding more capital. Essentially, banks could choose less intensive regulation, including more regulatory exemptions from activities like the Federal Reserve's stress tests, in return for adopting a strict, simple capital requirement.[16] Most commentators, including BGLN participants, remain skeptical that this plan will survive opposition from Democrats in the Senate.

Legislative changes may be limited by political opposition. One participant suggested that changes in the leadership of key agencies can be just as powerful as legislation in shaping regulatory policy: *"There is a greater appreciation that to achieve reform the right place to start is supervision. While the press likes to talk about Dodd-Frank, most post-crisis reform was done through supervisory standards."* These reforms could include changes to stress testing, recovery and resolution planning, and expectations for boards. In June, the US Treasury Department released a 147-page report proposing dozens of policy changes aimed at reducing the regulatory burden on the sector, most of which could be implemented by the heads of regulatory agencies.[17] Among the most notable recommendations include an "off-ramp" from some of the strictest supervisory standards for banks meeting certain equity thresholds, new restrictions on the Consumer Financial Protection Bureau, a more liberal interpretation of Volcker Rule enforcement, and switching stress testing from a one-year to a two-year cycle.[18]

"While the press likes to talk about Dodd-Frank, most post-crisis reform was done through supervisory standards."

– Participant

As the administration ramps up leadership appointments in key regulatory agencies, including at the Office of the Comptroller of the Currency, the Federal Reserve System, and the Federal Deposit Insurance Corporation,[19] participants expressed optimism about how banks, regulators, and supervisors could interact more effectively. Perhaps most relevant for board directors, participants highlighted press reports suggesting that senior supervisory leaders are considering a more principles-based approach to board supervision that will eliminate many of the specific directives given to boards.[20]

Though most bank leaders are supportive of some regulatory relief, several said that the status quo could be preferable to constant disruptive change. *"My number-one preference at this time would be to have a stable platform rather than roll things back. Instead of changing things every year, give us some stability,"* said one director.

Regulators are still considering how best to respond to innovation in financial services

In recent years, much attention has focused on how regulators are expanding the regulatory perimeter to include fintech firms or encouraging innovation using structures such as regulatory "sandboxes," which provide a space where companies can try new ideas under the watchful eye of regulators, but with some degree of regulatory forbearance, including the waiver of certain rules or limits to enforcement actions. At the end of 2016, the OCC announced that it was considering special-purpose national bank charters for fintech firms. The OCC also established an Office of Innovation, and last year it released a white paper expressing its views on "responsible innovation in the federal banking system" after gathering information from banks and fintech firms.[21] While participants agreed that these recent regulatory initiatives are positive, some pointed out that they don't really apply to the biggest banks. Participants discussed the following:

"If you are doing something [new] … or, similarly, if the way of doing something is significantly changed by technology, we expect significant scrutiny by the board."

– Supervisor

- **Regulators support innovation in big banks, but expect effective oversight and control.** Supervisors generally said they are supportive of innovation in large incumbents. One said, *"We want to promote innovation from inside the bank. It needs to be consistent with the bank's strategic goals. It is important that the innovation you are striving for is consistent with the long-term view the bank has in its strategic goals."* In addition, supervisors emphasized that they are looking at how boards are overseeing innovation and whether risks are well understood. One said, *"For a big bank, we would want to see the board very engaged. Even if it is not a huge transformation, if you are doing something outside your bank's traditional wheelhouse, it should get more board scrutiny than something you have been good at for a long time. If you are doing something* [new] *– a new business line or type of customer – or, similarly, if the way of doing something is significantly changed by technology, we expect significant scrutiny by the board."* Another said, *"The focus will be on controls. We don't get into the specificity on the right technology platform or whether you have the right specialists in place. From a strategic perspective, we expect the board to discuss the risks: What are the downsides? What could it mean for your reputation?"*

- **The burden of regulatory compliance needs to be managed.** As noted, banks operate in a highly-regulated environment and under close supervision. This may hamper innovation, but even with shifts in regulation and any softening of supervisory intensity, the reality is that this is simply a part of being a bank and therefore, needs to be managed. One director summarized, *"Do big banks have permission to fail? The simple answer is no."* Participants were encouraged to think differently about how they address the cost and burden of regulatory compliance, since innovative technologies and partnerships may offer solutions. One participant said, *"An important aspect of innovation to me is about how the industry can do something to bring these costs down. You each bear things individually, built in your own shops. How do you change that?"* Several regulators encouraged banks to explore shared utilities for non-competitive tasks, such as AML verification. Furthermore, all participants acknowledged that often it is a bank's own internal compliance and risk management teams being overly conservative that impedes innovation: *"We asked you to at least build a Honda and you built a Ferrari,"* said one supervisor. Boards have an important role to play in defining the right balance.

"I don't hear many bank leaders say, 'This is what we are going to be in five years' time … I stand for this, and I will be different.'"

– Participant

★★★

Directors, executives, and regulators acknowledge that fundamental business model transformation is hard. The giant incumbent banks have advantages that make major, rapid disruption of the industry unlikely. Yet, the financial services landscape is changing quickly, and with it customer expectations and behaviors. Determining a path forward will require a shared strategic vision of where the bank is headed and how it can distinguish itself through innovative approaches. A director said, *"Banks are taking different paths. I don't hear many bank leaders say, 'This is what we are going to be in five years' time. Here is the client base that matters to me and here is why we are important to them. I stand for this, and I will be different.' … I just see some of them cutting costs."* A bank's leaders decide how investing in innovation can help them differentiate from peers and other established and emerging competitors.

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.

Appendix: discussion participants

On June 8 in New York, Tapestry and EY hosted a BGLN meeting focused on innovation in banking and the changing US policy landscape and its implications for large banks. Insights from these discussions and numerous additional conversations with directors, executives, regulators, supervisors, and other thought leaders informed this *ViewPoints* and quotes from these discussions appear throughout.

The following individuals participated in these BGLN discussions:

Participants

- Nanci Caldwell, Non-Executive Director, CIBC
- Martha Cummings, Senior Vice President, Complex Financial Institutions, Financial Institution Supervision Group, Federal Reserve Bank of New York
- Howard Davies, Chair of the Board, RBS
- Ignacio "Nacho" Deschamps, Group Head, International Banking and Digital Transformation, Scotiabank
- Nick Donofrio, Non-Executive Director, BNY Mellon
- Bob Herz, Audit Committee Chair, Morgan Stanley
- Olivia Kirtley, Risk Management Committee Chair, US Bancorp
- Beth Knickerbocker, Chief Innovation Officer for the Office of Innovation, Office of the Comptroller of the Currency
- Axel P. Lehmann, Group Chief Operating Officer, UBS
- Brian Levitt, Chair of the Board, TD Bank
- Debby McWhinney, Non-Executive Director, Lloyds Banking Group
- Morris Morgan, Senior Deputy Comptroller for Large Bank Supervision, Office of the Comptroller of the Currency
- Kevin Parry, Audit Committee Chair, Nationwide Building Society
- Jim Quigley, Audit Committee Chair, Wells Fargo
- David Sidwell, Senior Independent Director and Risk Committee Chair, UBS
- Kate Stevenson, Corporate Governance Committee Chair, CIBC
- Katie Taylor, Chair of the Board, RBC
- Steve Weber, Professor, School of Information, Department of Political Science, UC Berkeley
- Tom Woods, Non-Executive Director, Bank of America

EY

- Peter Davis, Americas Advisory Managing Partner, Financial Services
- Roger Park, Innovation Leader, Strategy, FSO PI
- Marc Saidenberg, Principal, Financial Services

Tapestry Networks

- Dennis Andrade, Partner
- Jonathan Day, Vice Chairman
- Colin Erhardt, Associate

Endnotes

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