Revolutionary change is transforming the financial services landscape

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> *"Revolutions only get called with hindsight. At the time, they are generally experienced as incremental steps that later are viewed as an extraordinary period of change. We are in a period of accelerated evolution that will be called a revolution in financial services."*
>
> – Summit participant

Financial services companies have been operating for hundreds of years, many of them weathering period after period of disruptive change: global wars, financial and economic crises, information technologies ranging from the telegraph to modern social media.

Now, however, fundamental shifts in the technological, macroeconomic, geopolitical, and competitive landscape suggest that the waves of change buffeting the financial sector may collectively represent more than just another cycle: they could be changing its ongoing structure.

Former US Vice President Al Gore once said, "We are vulnerable to confusing the unprecedented with the improbable … if something has never happened before, we are generally safe in assuming it is not going to happen in the future, but the exceptions can kill you."[1] The change under way in financial services may be unprecedented, but, as a summit participant asserted, *"It is unchallengeable; it is real. The speed of change and the impact on business models is picking up, not slowing down."* Technology is lowering barriers to entry that have protected large financial institutions from new competition. It is raising serious questions about the value of their legacy assets and transforming how they do business.

On October 5–6, 2016, more than 75 directors and executives from among the largest global financial institutions, senior regulators, financial technology (fintech) entrepreneurs, and other subject matter experts met in London for the Financial Services Leadership Summit. The summit marked the culmination of a series of discussions with participants in the Bank and Insurance Governance Leadership Networks on the forces impacting the financial services landscape and the implications for financial institutions and their regulators.

Though some participants questioned the pace and scale of predicted changes coming to the sector, it is increasingly clear that all financial institutions must adapt to a changing landscape or risk obsolescence. A summit participant predicted *"a scale of transformation few of us have ever seen,"* adding, *"You cannot move incrementally from where you are now, but need to try to imagine what the future will look like and then determine what you can do to position yourself, and how quickly."* Large incumbents, another participant noted, face a particular challenge: *"It is easier to start something new than transform a business."*

This *ViewPoints*[2] synthesizes key themes emerging from the summit and related discussions with financial services leaders over the second half of 2016. These themes are expanded upon in the following sections:

- **Technology-fueled transformation is changing the competitive landscape** ***(pages 4-16).*** Many large financial institutions are in the early stages of transforming themselves into more agile, digital-age companies. Under increased competitive pressure from fintech and other technology companies, and facing a future of slower economic growth and depressed returns, they are identifying ways to leverage technology to improve customer service, increase efficiency, simplify structures and operations, and make better use of their data. They are also increasingly identifying where they can partner with technology companies. Transformation will require some difficult trade-offs and new ways of thinking about talent and culture if large firms are to successfully address legacy structures, processes, and systems to build a platform for the future.

- **Unprecedented economic and political risks are challenging global strategies** ***(pages 17-26).*** One participant noted, *"What is different about change today is that we feel negative and threatened because of the macroeconomic environment. We used to see all this change and call it opportunity."* Financial institutions are operating in an unprecedented monetary- and fiscal-policy environment, and that environment may be with us for some time, as the underlying causes of slow growth are largely structural, not cyclical. At the same time, the political will and leadership to address these issues seems largely absent, with constructive engagement between financial institutions and governments threatened by populist politics. Faced with such large-scale sources of uncertainty, financial institutions will need to take a long-term view of sustainability to survive a wide range of economic and policy scenarios.

- **Regulatory and supervisory approaches will continue to evolve** ***(pages 27-34).*** Sam Woods, the new head of the UK's Prudential Regulation Authority, said in a recent speech, "The ways in which firms organise themselves, and the tools by which we apply our supervisory judgements, are shaped by global regulatory standards. And in those standards, there has been a revolution."[3] The reforms, now nearly complete, have had a major impact on financial institutions. Yet, as the landscape continues to change, regulation must continue to adapt to a new world. Though there remain important outstanding questions regarding the final implementation of the global prudential reform agenda, the conduct agenda is likely to see the greatest change. Many regulators are renewing their focus on culture, governance, and consumer protection issues, and considering ways to expand the regulatory perimeter to bring new entrants into the fold and allow for innovation in established firms. But regulation will always lag behind market developments. The revolutionary change in the financial services landscape is likely to be met with a more gradual process of regulatory evolution.

The financial services industry faces daunting challenges. There are some reasons for optimism: large, established financial institutions still have certain advantages over new competitors. A few established players will emerge from this transition as leaders and innovators. Doing so may require some difficult decisions grounded in a long-term vision, even in the face of short-term pressures. Boards will need to ensure that their institutions can navigate this turbulent environment and position themselves for future success. A participant stated, *"It is the role of the chairman to create an agenda where people understand that dramatic change is needed to survive. The opposite happens at many board meetings. We can do better."*

Technology-fueled transformation is changing the competitive landscape

> *"When we emerge from all of this – and I don't know when that will be – things will look very different. The products and services, the shape of organizations, who your major competitors are – all of this will be different."* – Director

A director compared the changes in financial services to a *"geological process"* in which the heat and pressure generated by technological innovation, regulation, changing customer preferences, and macroeconomic conditions will transform institutions into something entirely new. Perhaps the most powerful force, and the one that also offers a means of addressing current challenges, is technological innovation. Technology has the power to remake incumbent businesses from the inside out and to reshape and reveal customer preferences. It has also given birth to legions of nimble fintech start-ups. These organizations, unencumbered by legacy assets and high capital requirements, are changing the financial landscape both as competitors and as partners.

The process of transformation will be challenging, and some institutions may not survive it. Those that emerge as dominant will be leaner and will offer a different array of services and products. They will face new competitors and have more partners. Some suggest their role in society may also shift, particularly if they continue to retreat from long-term savings and investment products.

This section of *ViewPoints* addresses the role technology is playing in the transformation of the world's largest financial institutions and the competitive landscape in which they operate. It is guided by the following themes:

- **Incumbents must transform into digital-age companies**
- **Existing institutions will face a greater variety of competitors in the future**

"The only opportunity to progress is technology … It is the only way we have to survive."
– Executive

Incumbents must transform into digital-age companies

"Once you understand there is a risk of inaction or not doing enough, then you have to examine your structure, strategy, and everything in a new way," said one director. Others said they may be facing an existential challenge that will require them to ask even more fundamental questions about their relevance: *"It is less about 'am I in this market or this product line' and more about 'is my model going to work in the future?'"* When one participant asked, *"How long do we have to respond?"* another answered immediately, *"It's urgent."* In that light, the leaders of many financial institutions are responding by refining their strategies and determining how they can build flexible, adaptable platforms. Sustainable models are likely to include improved, efficient features of today's models as well as new methods of generating revenue.

Fintech firms will have a profound effect on incumbent institutions

Financial technology has two broad components, the focus on improving the efficiency and effectiveness of processes, services, and products within established incumbents, and the advent of fintech companies – technology-enabled financial services companies – that are developing and deploying new technologies, often in more targeted and innovative ways. One executive concluded, *"The only opportunity to progress is technology … it is the only way we have to survive."* Large financial institutions are in the process of transforming the way they operate and deliver services through technology. Whether technology is offering incremental or transfomative change, it is integral to everything financial services companies are doing. An executive remarked, *"Technology is driving competition. Competition is driving strategy. Strategy drives objectives."*

"I don't see an Uber moment within financial services, but I do see fintech companies having an impact."
– Director

Few doubt that the fintech sector will have a significant impact on traditional financial services, but skepticism remains regarding how truly disruptive the fintech boom will be. A participant observed, *"I don't see an Uber moment within financial services, but I do see fintech companies having an impact."* Some believe that incumbent firms have both the time to adapt and the scale and reputation to outcompete the new entrants. One participant asserted, *"Not all innovations are equal. It would be easy to overstate how difficult it would be for incumbents to take on fintechs … On the other hand, if you tried to take on Apple, that's something altogether different."* But some participants felt that large firms are in denial about the impact of fintech, given fintech's growth to date, the low barriers to entry, and ability to scale quickly. Still others said it is too difficult, or too early, to tell.

Boards and management teams have the unenviable task of separating the hype from the true competitive threats and opportunities. Different product types and business models face different effects, compounding the challenge. One director said, *"Insurance is more vulnerable than banking. Asset managers are probably most vulnerable unless they can get much more efficient fast. I think people look around and say, 'Do I really need this? Why am I paying the fees?' I think the real revolution is coming to asset management."*

"We are obsessed with the client, not with technology. We think first about what needs customers have and how we can meet them, and then we work out how to do this by using technology."
– Fintech Executive

While the ultimate impact of fintech start-ups is not yet clear, it is certainly putting pressure on incumbents, especially in the areas of payments, lending, and distribution. Participants shared the following perspectives on how fintech is changing incumbents:

- **Fintech firms excel at putting customers first, forcing incumbents to respond or risk disintermediation.** A central goal for all fintech companies is to leverage technology to reduce friction for the customer. Technology is the means, but customer service is the goal. One fintech executive noted, *"We are obsessed with the client, not with technology. We think first about what needs customers have and how we can meet them, and then we work out how to do this by using technology."* The fact that start-ups are so adept at connecting to customers led one director to observe, *"Customer disintermediation is the largest area of fintech activity."* Several directors acknowledged that financial institutions themselves are to blame for opening the door to these new competitors. One said, *"Banks have gone backwards in client service,"* while another stated, *"The truth is fintechs shouldn't exist. They are offensive to everyone in this room, and I love it. We must do better."*

- **Financial institutions will benefit from increasing collaboration with start-ups.** Most participants, including executives from the fintech firms themselves, view the fintech sector as both a threat and an opportunity for incumbents. Several years ago, the dominant theory was, as Jamie Dimon famously said, that fintech firms "all want to eat our lunch."[4] While a number of groups say they want to replace incumbents as the main providers of certain products, others see themselves primarily as partners. In fact, investment in collaborative projects between start-ups and incumbents increased by 138% in 2015 and now represents 44% of all fintech investment, while investment in fintech companies that compete with incumbents only increased by 23%.[5]
- **The rise of fintech will force incumbents to become more efficient.** One director summarized this effect as follows: *"Existing players have moved in pricing to match these competitors. Fintech businesses have succeeded in transferring value to the customer. The real impact of innovation on the industry is the reaction to it. For instance, the cost of payments has come down."*

"Fintech businesses have succeeded in transferring value to the customer. The real impact of innovation on the industry is the reaction to it."
– Director

Financial institutions will become more specialized

Participants agreed that financial institutions are likely to become more specialized in the future and to partner with other organizations to provide a full range of services. As Kevin Koenig, EY Financial Services Global Insurance Data and Analytics Leader suggested, *"The days of being all things to all people are numbered."* Another participant agreed: *"[Big financial institutions] say they can do all of it, but the truth is parts of it can be done better externally."* Experts increasingly refer to this process as "platformification": financial institutions become the platforms that perform core financial transactions and some specialized services, and that link customers directly to fintech firms or other partners.

"[Big financial institutions] say they can do all of it, but the truth is parts of it can be done better externally."
– Participant

Though incumbent firms are reluctant to abandon parts of the value chain that they view as strategic, participants agreed that in some value-creating activities, large providers tend to perform poorly against potential partner organizations or competitors. More importantly, the many macroeconomic, regulatory, and other challenges may make a monolithic, vertically integrated model unsustainable.

Platform Financial Services Taxonomy[6]

The naming conventions for new methods of financial service provision are evolving, but some consensus is emerging around the most salient themes, trends, and terms. At present, many of these developments are most closely connected to banking, though some experts posit insurance and asset management could experience similar trends. Below is an overview of some of these terms:

- **Platform Strategy.** This strategy defines what capabilities are essential to the institution and what capabilities may be ceded to partners. Platform owners must determine rules of engagement, governance, financial relationships, data governance and privacy etc. Application programming interfaces (APIs) are an important way in which institutions interact with partners.

Platform Financial Services Taxonomy *contd.*

- **Marketplace Banking**. Financial providers who choose a marketplace platform strategy develop a digital marketplace where third parties can sell to the provider's customers. Providers have a role in connecting customers to appropriate products and services, which may or may not be their own. Incumbents have an advantage in creating marketplaces, though new entrants may follow.
- **Bank/Insurance as a Service (B/IaaS).** In this model, providers shift from being builders of financial solutions to assemblers of services, products, and other offerings. Services are unbundled and may not be attached to core products such as insurance policies or current/checking accounts. This approach dramatically reduces the cost of delivering a service. Expert Chris Skinner noted, "This is what banking is becoming: an assembler of financial management tools, delivered in the way that works best for their clients. No longer do banks need to build and control the components. They can just source them."[7]

Fundamental shifts in strategy and operations lie ahead

Large financial institutions need to be more agile if they are going to compete in a rapidly changing, technology-driven marketplace. As one director said, *"When you can't see what the future holds, you have to be ready for anything. The last several years have proven our businesses can adapt, but not easily. In the future we will have to do better."*

"The last several years have proven our businesses can adapt, but not easily. In the future we will have to do better."
– Director

One director summarized his group's strategic shift as follows: *"We are reexamining product offerings, looking to address margins by attacking expenses, and we will be looking at underperforming legacy assets. So institutions will look different. Institutions are being reshaped and recalibrated."* Participants identified the following trends, which are common among institutions transitioning from an industrial-age giants to modern, digital financial services companies:

- **Simplifying structures and focusing on core businesses.** *"As banks have evolved, they have added and added and added complexity without taking anything away. You can't run a technology industry like that,"* noted one participant. As sprawling enterprises become more and more difficult to manage, many financial institutions are simplifying operations. One director said, *"Historically, we made do with cobbled-together legacy systems. That is too expensive today. If there is a regulatory change or a new product, you have to update your systems 10 different times. That level of operational effectiveness is impossible. We all need to simplify operations."* Firms are increasingly limiting activities to those areas in which they can truly differentiate themselves from competitors. One director noted, *"All financial institutions will be spending more time looking to simplify themselves and narrow the focus of the businesses they are in. You have to make a calculated decision regarding where to divest and identify ways to release trapped capital and deploy it more effectively."* Banks and insurers face pressure to move into capital-light activities, like wealth management or treasury services, because poor investment returns and onerous capital requirements make some products uneconomic.

Institutions also face important decisions about whether to leave some markets. One director said, *"At one point, you wanted a flag in every country. That introduces real complexity. One of our core competencies is serving multinational companies in all the places they do business. But that doesn't mean you write life insurance or have bank branches in all of these countries."* One bank director asked, *"Do international models from the 1980s and 1990s still make sense going forward?"*

"Do international models from the 1980s and 1990s still make sense going forward?"
– Director

- **Simplifying products and services.** Customer demands, capital needs, and digital forms of distribution *"mean that product design will also have to change. Products become simpler … so you can use them on a phone,"* said one director. Another asked, *"If salesmen are gone, who will be there to explain these complex products? The answer is, we will have to build simpler constructs."* Another noted, *"There is a big lack of trust, and a key way to address it is to simplify. If people know what they are paying for, there is more trust."*

- **Increasing outsourcing and collaboration with fintech and other partners.** As organizations narrow what they view as core, they necessarily cede some activities to others. These activities and functions may include information technology (IT), human resources, asset management, claims, and distribution. Many participants agreed with one executive who said, *"If they can do it better and more cheaply than we can, why would we not partner? That is the future."* An executive emphasized the importance of *"aligning with the tech innovators earlier in the process so that applications are not designed in a vacuum."* A director pointed out that the pool of potential partners is not limited to fintech firms: *"Financial institutions regard each other as competitors. Is there a case to be made that we should partner with those who do certain things well, even among historical competitors?"* Equally, there are opportunities to pool resources in industry utilities, for example to conduct financial crime due diligence.

"If salesmen are gone, who will be there to explain these complex products? The answer is, we will have to build simpler constructs."
– Director

Some directors fear their organizations could be relegated to limited and less profitable portions of the value chain. One insurance director concluded, *"New technology will lead to the removal of support functions, leaving only product design, manufacturing, underwriting, and claims for the traditional insurers. The changes will leave insurers as the designers and integrators of all these parts. It leaves us as the capital provider and risk taker. That will be our primary reason for being."*

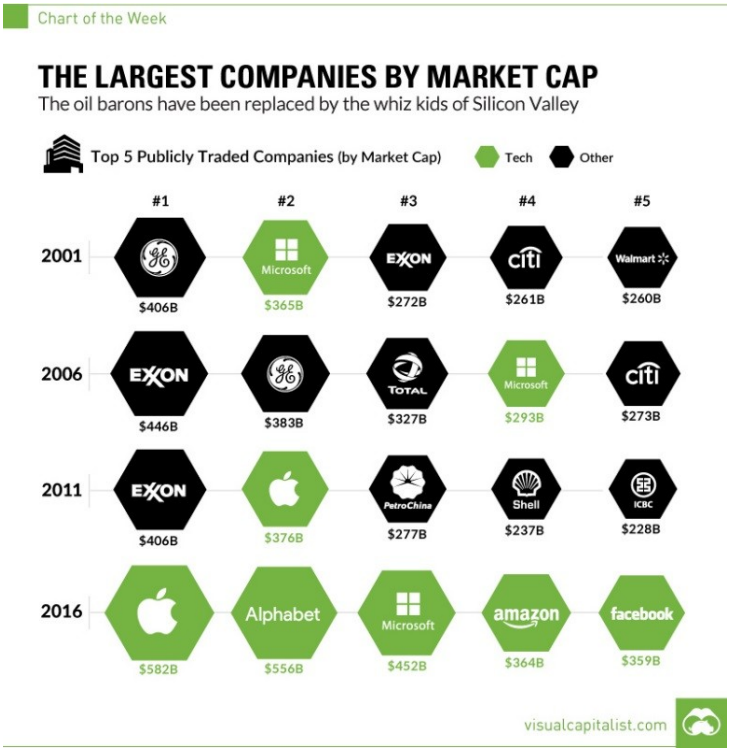
"Financial institutions regard each other as competitors. Is there a case to be made that we should partner with those who do certain things well, even among historical competitors?"
– Director

- **Uncovering new sources of value.** Participants said that technology is most often viewed as a tool to improve existing services and products and ensure they remain viable. However, institutions are also keen to uncover fundamentally new sources of value. Cyber insurance and risk mitigation, as opposed to pure protection, are two of several areas insurers are currently exploring. A bank director said, *"We have to develop new sources of income, for example, identifying ways to monetize our data. Have we got the right mix between net interest margin models and fee-based services?"* One executive noted, *"Business models need to evolve to include risk mitigation and to provide greater value to consumers. The opposite of this is a singular focus on risk selection, which is very narrow minded, limiting, and will ultimately be unsuccessful."*

- **Balancing multichannel capabilities.** For the foreseeable future, customers will demand a variety of service channels. Emphasizing the importance of digital channels, one director noted, *"[Customers] want technology, not paper. There is a statistic that 45% of 16-year-olds don't have a signature."* At the same time, a shrinking but important percentage of customers still require face-to-face service. Furthermore, many individual customers prefer different channels for different types of services and transactions. Aggressive use of technology may be required for lower-margin products to improve profitability, but one participant found that *"people want the optionality of tech or personal touch at the higher end … I think the grim reaper is catching up with the institutions that are not digital throughout the enterprise."*

- **Reducing headcount.** Fifteen years ago most of the world's most valuable companies were traditional industrials, retailers, or banks. Today, they are all tech companies, which have significantly fewer employees and generate far more value per employee.[8] One participant said, *"The number of people we, as an industry, will employ is going way down."* The single greatest cost lever for financial institutions is people, and firms are drastically reducing the number of direct and affiliated employees. Since the crisis, banks have shed 10% of their workforces, or roughly 212,000 people[9], and many are in the midst of ongoing reductions.

  Continued layoffs and restructurings are likely to cause significant disruptions and present morale and other challenges. *"To make 2,000 people redundant has an enormously damaging impact on culture,"* said one executive. *"The trouble is, you can't escape the inevitable pain the industry has to manage through."* Directors point to these obvious risks as one reason some firms have delayed taking action in key areas, for example in insurance distribution. One insurance director said, *"If we don't navigate the shift to digital distribution, then we become very vulnerable. We have to do it. The career salesforce has been a huge asset for us for so long that we have been reluctant to disrupt the model, but it has to shift."*



Source: Chris Skinner, "If You Want to Convince the Bank to Change, Read This Blog," *Finanser: Chris Skinner's Blog,* October 2016.

Exploring the connection between brand value, reputation, and trust

As institutions contemplate partnerships, strategic shifts, and structural changes, brand strength and positioning will be important considerations. Most institutions view their brands as highly valuable assets and a source of consumer trust. However, brand and reputation can also be a liability:

- **Brand as asset**. With histories that may extend several hundred years, some of the largest financial firms view their brands as iconic and their franchise value as a significant source of strength. One director summarized brand value as follows: *"There are still great advantages to incumbency, like brand and financial strength. In the crisis, people didn't move to the challenger banks or fintechs; they moved to HSBC for comfort."* Brand recognition also confers a significant advantage to incumbents over start-ups, which have to spend significantly on marketing to build awareness.

- **Brand as liability.** Individual firms and the sector as a whole have done massive damage to their reputations through real and perceived misconduct. One executive noted, *"You cannot let people divert from the core point, which is that values drive value. Many institutions are still trading below book value. That is a profound statement about how investors view them."* A recent paper by Natasha Sarin and Larry Summers suggests that decreases in franchise value are now so great as to make the financial system less safe than before the crisis, despite extensive regulation, greater capital levels and decreased leverage.[10] A summit participant observed, *"Brands in financial services aren't worth very much in many cases … We need to set higher brand standards."*

"One of the things scaring most insurers is 90% of the data they house is not used in anything … It is so expensive to maintain, and it could be used for so much more."
– Kevin Koenig, EY

A number of developing technologies are poised to revolutionize operations

Participants noted the potential for a range of technologies to accelerate the transformation of the sector:

- **Open-source APIs.** Sometimes called open or open-source banking, APIs enable third parties to access institutions' core systems. Third-party applications typically layer on top of a provider's internal applications. Financial institutions can use APIs for services such as reporting, or to enable other services clients demand. In the European Union, banks are legally required to provide third-party access to current accounts via APIs. In the United States, providers are increasingly volunteering to open up their systems to outside groups to develop complementary applications.[11]

- **Data analytics.** EY's Kevin Koenig noted, *"One of the things scaring most insurers is 90% of the data they house is not used for anything. It is not leveraged in any way. It is so expensive to maintain, and it could be used for so much more."* The same is true for banks. Directors, executives, and regulators now seem to agree that firms are on the cusp of being able to capitalize on this data. One director noted, *"There are big changes*

coming down the pipeline for pricing, business models, and loss reserves. We are not there yet, but inside five years, expect big changes."

- **Robotic process automation (RPA).** RPA allows firms to automate administrative processes across the enterprise (e.g., front and back office, as well as support functions.) RPA can be used for tasks as various as account creation, client onboarding, compliance reporting, and fraud detection. According to one director, *"We are at the tip of the iceberg with automation. There are plenty of things it won't work for – say, where judgment is involved – but so much of what we do is bound by rules that RPA is a logical next step."*

"We are at the tip of the iceberg with automation."
– Director

- **Blockchain.** Blockchain, a widely discussed technology, creates shared databases (ledgers) that are distributed and are therefore not dependent on any single data keeper or point of failure. For large institutions, this technology could enable automatic execution of contracts and fundamentally reshape the way value is transferred in a variety of areas, including payments, trade finance, capital markets, and insurance contracts.[12] Many institutions are experimenting with the technology, but more widespread adoption will require greater standardization, testing, and security. An executive predicted blockchain would have a major impact in a few years, but warned, *"It is no panacea."*

Understanding the risks of new technologies

Successful application of new technologies could reduce costs, make possible faster and more accurate processing, and improve customer service, security, and fraud detection. However, technology, particularly transformative technology, broadly applied, brings with it a wide array of risks. Participants highlighted just a few of them:

- **Increased fraud via third-party applications.** One director said, *"APIs and third parties may be great for customers, but there is a heightened rate of fraud and unauthorized transactions. Right now, if a transaction is authorized by the customer, the default assumption is the banks will cover it, but different banks are taking different attitudes on the liability. The idea that banks have an open checkbook is absolutely terrifying if it is the customer making the mistake. Can the old-world rules apply in the digital world?"*
- **Automation that perpetuates or exacerbates errors.** One director observed that there are many parts of the business that are now too technologically complex for one person, or sometimes even whole teams, to understand. This makes it difficult to detect and fix problems. A CRO asked, *"What happens when bad coding goes undetected? How do you ensure you have the right kind of controls in place?"*

Understanding the risks of new technologies *contd.*

- **Workforce dislocations.** New technologies have the potential to make large parts of the workforce obsolete. Digital distribution threatens to eliminate agents. Artificial Intelligence and RPA also may threaten employees' jobs. One participant said that models of some firms' future needs suggested that those firms might be overstaffed by as much as 50%. Significant layoffs or restructurings will create disruption and dislocation and raise questions about workforce planning and transition assistance. Finally, some participants worry that broad workforce reductions, coupled with similar reductions across the sector and the broader economy, will shrink the market for products and services.
- **Better data could lead to more financial exclusion.** Finally, better data and analytics could lead to greater number of unbankable or uninsurable people. *"As more data and analytical capabilities become available and the market atomizes into smaller risk pools, the remaining lowest, least desirable risks will be people of lower income, lower education, poor behaviors, unlucky circumstances etcetera. This will be a big political problem for the financial services industry,"* said one director.

Financial institutions must encourage and enable innovation

Participants stressed the importance of innovation not for its own sake, but to make life better for customers – for example, by providing products and services faster, at more convenient times, with more accuracy, etc. At the same time, all large financial institutions are under pressure to address costs and improve returns. *"When is innovation necessary? When costs need to come down,"* said one participant. Firms are therefore focused on ensuring they have the culture and talent to drive innovation:

- **Creating innovation cultures.** Incumbents need to encourage innovation to spur development of new sources of value, whether in the form of new products and services or value-creating partnerships. However, encouraging and developing innovation in-house is not straightforward, and cultural change necessitates overcoming a number of obstacles. One participant acknowledged that *"innovation is tough in big organizations,"* largely because, as Roger Park EY Partner, FS Strategy and Innovation, acknowledged, *"Investment priorities are different in large organizations. If you are a start-up you can pitch an idea to 20 different venture capital firms and only one has to say yes. In a big bank, a new idea may also have to go to 20 different people, but it only takes one to say no to kill it."* Still, most participants agreed with one who said, *"We have some pretty smart, digitally savvy people with huge resources behind them. There is no reason big organizations can't do it. It is just about the attitude."* A fintech executive was less sanguine: *"The biggest advantage for a start-up is the amount of energy put into the present and future versus the past. Running a big business is not a small thing. Your day becomes absorbed with coping with the latest emergency. Very little energy is spent on what you are doing next. On one hand, you are at a fabulous organization and there are all these resources. [But] you don't allow leaders in your business to focus on the future.*

"The biggest advantage for a start-up is the amount of energy put into the present and future versus the past."
– Fintech Executive

Maybe if you are lucky you can at least focus on the present." Another was even blunter, stating, *"I don't buy it for a second that big incumbents can do all the things that fintech companies do."* But another participant argued, *"There is a misconception that we need innovation that involves lots of lightbulbs going off. It's as much a matter of applying technology that's already around."*

Many firms have established innovation centers that allow employees freedom to experiment outside the constraints and culture of core businesses. Recognizing the challenges of overcoming legacy systems and cultures, others are setting up entirely new, or "greenfield," operations. These are wholly separate companies that can carry new businesses forward without legacy burdens. One executive said, *"If you can separate the past from the future, that is key. Put yourself in a position where you can be really agile. The benefits of replatforming are colossal."*

- **Realigning talent.** Innovation cultures are also important because they make it possible for incumbents to attract the kind of talent necessary for succeeding in the future. As they move forward, financial institutions will need people with technical skills in areas such as data science, coding, and cybersecurity. People with a strong customer orientation will also be important. One insurance executive said, *"We are hiring people who were customer centric elsewhere, not insurance people. We can train them on insurance."* However, these skills are in great demand across many industries, and incumbents worry about their ability to compete successfully against start-ups in attracting them. One fintech executive said, *"Attraction and retention of the right skill set is paramount. My environment will never be replicated inside the core of a large firm."* This is likely to remain a challenge in the future, particularly if pure cash compensation, the traditional inducement offered by incumbents, proves less attractive to sought-after talent than less tangible assets such as opportunity, impact, and culture. One fintech executive said, *"We don't pay them a huge amount. It is much less than a Goldman Sachs. We don't pay much in bonuses either. We try to open as much equity as we can as well as create a fantastic work environment and lots of intellectual stimulation."*

"The biggest players are making dozens of bets, knowing that only a small number of them will work out."
– Participant

- **Spreading technology bets.** Despite incumbents' best efforts to encourage innovation, one participant warned, *"There is an inherent randomness to innovation. You can try to incubate it, but you may not get the one that will transform the industry. The amount of innovation you get is not equal to the number of people on your 'innovation committee.'"* A variety of technologies could transform the industry, and certain firms are leveraging those technologies in innovative ways, but few clear winners have emerged. One director described the result: *"Many incumbents are adopting multiple models simultaneously: networking in the industry, taking an ecosystem approach, building internally, partnering, acquiring, and engaging in joint ventures. These are not mutually exclusive – it is better to engage in most or all of them, depending on the line of business, customer, market opportunities, organizational capabilities, time sensitivity etc."* An industry expert agreed, noting *"The biggest players are making dozens of bets, knowing that only a small number of them will work out."*

Many large institutions are still in the early stages of the innovation agenda. A participant noted, *"Five years ago we were focused on survival. Banks in particular haven't really been able to pivot to [innovation], maybe until now."* As firms experiment and try different things,

"the winners will be the ones who can scale and make it operational," according to one director, who continued, *"They may not exist today."*

Established institutions will face a greater variety of competitors in the future

"The future is predictable. Its constituents are unknown," observed one participant, suggesting the direction of travel for financial services may be clear, but who will emerge as the major competitors is less apparent. As the sector and its participants transform, the nature of competition is shifting. Participants observe two distinct trends. First, traditional boundaries between banking, insurance, and asset management have become more porous. Firms that have resided in one subsector increasingly are exploring products and services in other subsectors as traditional competitors refine their strategic focus. Second, as noted above, financial services is experiencing an influx of new entrants and non-traditional providers, including fintech and alternative-capital firms, who are competing for parts of the value chain historically reserved for large institutions. As a result, *"Many firms like UBS, Barclays, and maybe even Deutsche Bank are dropping out of the global big-bank game and are facing new competitors that are different than their historical set,"* said one director.

> *"Many firms … are dropping out of the global big-bank game and are facing new competitors that are different than their historical set."*
> – Director

Fintech firms, both friend and foe, continue to proliferate

Various fintech lists suggest there are now more than 6,000 fintech firms around the globe.[13] A participant suggested more than double that number of firms have been created in the last five years. Total global investment in the sector totaled roughly $50 billion in 2010–2015, with 25% of the investment made in the first two quarters of 2015 alone.[14] Lending and payments are the hottest areas, though so-called insurtech and automated portfolio-management tools have seen a surge of activity in the last several years. And virtually all businesses, including wholesale activities, are now being targeted by specialized technology firms.

Few of these companies are large enough to take meaningful market share, but increasing competition is putting pressure on margins in some of the most profitable businesses, which are being cherry-picked by new entrants. Goldman Sachs estimates that new entrants could steal up to $4.7 trillion in annual revenue and $470 billion in profit from established financial services companies.[15]

However, some participants believe that as the fintech sector matures, it will undergo consolidation. Some larger fintech players, including PayPal, Prosper Marketplace, and Ant Financial, have made significant acquisitions of other fintech firms in the last year.[16] Similarly, a number of banks, asset managers, and insurers have acquired fintech firms.[17] One director predicted, *"Nine out of 10 of these companies won't make it. The one that does may be the one attaching itself to the existing infrastructure."* Another agreed: *"Fintech is likely to get absorbed. Most of the people backing challengers aren't trying to build the Barclays of tomorrow … They want to cash out."* Several participants were of the opinion that a very small number of challenger banks or other fintech firms might be able to achieve scale, becoming the Amazons or Googles of tomorrow, but thought it would be very difficult.

How will new entrants fare under adverse circumstances?

As the competitive environment becomes more diverse, many traditional institutions wonder how new entrants will fare when their markets or financial conditions deteriorate. Will new actors possess sufficient expertise and resources to weather storms, especially if they fall outside robust regulation? One executive said, *"[We should be] avoiding taking the risk of the system from banks, [where it] is handled by people with a lot of experience, and moving it all to people who don't have the experience and understanding of what they are doing."* Another director asked, *"If we are moving into a turbulent period, which we are, what will that do to the new entrants that grew up in a relatively benign environment?"* How well new entrants adjust to adverse conditions will affect their competitors and partners, but could also have implications for market capacity and financial stability more broadly.

Non-traditional financial intermediation is growing

Alternative asset managers see opportunity to diversify and grow as traditional players shed asset-intensive products or underperform. One CRO summarized the migration to non-traditional intermediates this way: *"The banking market is changing structurally as banks look to hold less assets. The natural places to take those up are asset managers and insurance companies … So, who is stepping into that breach?"* Growth in alternative asset management and investment firms, including hedge and private equity funds, is well documented: in 2014, assets of non-traditional financial intermediaries (i.e., excluding banks, insurers, and pension funds) within 20 advanced economies and the euro area grew to $80 trillion.[18] Growth was the result of a significant increase in non-bank credit intermediation, largely from capital markets, and from increases in valuation.[19] Similarly, for the last decade, alternative capital in reinsurance, including insurance-linked securities, contingent equity, and other contingent capital, has been growing.[20] In 2015, alternative capital increased by 12% to $72 billion, which accounts for roughly 13% of the market, at the same time that traditional capital shrank by 4%.[21]

Traditional institutions are moving into other subsectors

Several directors noted that traditional non-bank institutions, including asset managers and insurers, are also exploring the provision of products and services that are typically the purview of other subsectors. While these movements are somewhat small, they suggest a blurring of lines that could expand in the future. Examples include the recent purchase of EverBank by the financial services firm TIAA[22] and the migration of some reinsurers into primary insurance.[23] Similarly, some insurers have expressed a desire to build out commercial loan portfolios as banks shed these businesses. One director suggested insurers could move into lending if they are granted reprieves from some regulatory constraints: *"Right now, a lot of loans – especially small and medium-sized corporate loans – are being pushed to separate asset management firms and pension funds. Insurers cannot take them on because [the loans] are not rated, but many of the liabilities are non-callable, which makes for a good match for insurers. We need to start a dialogue with regulators about a different approach."*

One CRO asked whether this trend would continue, *"Are hedge funds accumulating assets for longer holding periods, or do they just see undervalued assets in the short term?"*

Some products are disappearing from the marketplace

People are not saving enough as they age, and institutions are retreating from many of the products and services that have historically helped them save. Given that the population in both Europe and America is aging, this lack of savings is likely to result in significant unmet needs in the future. One director summarized the situation this way:

> *Banks have backed away from encouraging savings and advice. The insurance savings business has been decimated. Annuities are basically gone, and no one is providing advice. This is a collective issue that needs to be addressed … What is the role of banks and insurers and asset managers in attracting people to save and invest for future needs? You have two industries trying to work out how to provide products in a world where young people are not saving enough.*

"What is the role of banks and insurers and asset managers in attracting people to save and invest for future needs?"

– Director

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The transformation of individual institutions and the advent of new competitors is radically changing the competitive landscape for traditional financial institutions. In the future, there are likely to be more entities to partner with and to compete against, though the arenas for competition may be narrower. While technology will be at the center of these changes, an executive reminded, *"We need to think in business models and strategy, not technology. It's about imagination."*

Several directors wondered whether, as new service paradigms and providers emerge, the nature of the sector's relationship to society will change. One director concluded, *"Society has looked to our institutions to provide essential services – protection, lending, long-term savings, maturity transformation, risk transfer, and so on. That is the arrangement. So we'd better ensure we continue to do these things and do them well."* One director countered the talk of revolutionary change, saying, *"Yes, there are changes in the business model and regulation, but the human condition hasn't changed. We still require a degree of trust, a decent return. All the needs are still there. The industry has to cater to the fundamental condition."* The task will be to figure out how to do that while remaining profitable.

Unprecedented economic and political risks are challenging global strategies

"Will I do a $300,000 remodel of my home if I'm not sure what the world will look like in three years? It is a similar issue for CEOs. That is the problem, the uncertainty. We don't know whether to make investment decisions." – Director

This comment from a director at the Financial Services Leadership Summit captures the generally gloomy mood of the participants about the state of the world. Boards and executives, under pressure to transform their institutions and improve returns, are facing economic and political headwinds. While financial institutions and their regulators have historically coped with short-term instabilities, what concerns today's leaders is the specter of protracted low growth and low interest rates. Even if the political leadership and will to tackle the fundamental issues were present, policymakers are running out of tools with which to act.

"The macro environment is the biggest risk to our business model."
– Participant

Directors, executives, and regulators are all concerned about and bewildered by the state of the global economy. One director captured it well: *"I'm still not sure I can get my head around the [current macroeconomic conditions]. We are in an Alice-in-Wonderland world."* In response to the global financial crisis, central banks and governments implemented unprecedented monetary and fiscal policies, creating macroeconomic conditions never before seen by modern financial institutions. At the same time, a fundamental shift in global politics is upending the consensus that has dominated international economic and trade policy since World War II. Historical frames of reference and assumptions regarding cyclical root causes may no longer be relevant. Boards will need to adopt longer-term time horizons and challenge assumptions built into business models. Key themes from these discussions are outlined in the following sections:

- **Current conditions are challenging the viability of business models**
- **Understanding the structural causes underlying current trends is essential**

Current conditions are challenging the viability of business models

Most participants agreed that current macroeconomic and geopolitical challenges must be better integrated into their strategic risk discussions, given the threat that they pose to the sustainability of financial institutions. Doing so means considering a broader range of possible scenarios. One director stated, *"There are two separate levels to think about … One is short term. The other is macro, the major forces, the far horizon. Non-executive directors have to be concerned with the long term: how do you keep this thing going?"*

"It is really hard to get your mind around negative rates … All the conventional wisdom is out the window."
– Participant

Persistently low, and even negative, interest rates are straining business models

The combination of persistent low and negative interest rates is creating profound challenges for banks, insurers, and asset managers. A participant stated, *"The macro environment is the biggest risk to our business model."* Since the financial crisis began, global interest rates on public and private debt have fallen precipitously. Nominal interest rates are the lowest in generations, and negative interest rates – never before experienced – are pervasive and extending into longer durations and more deeply negative territory. A participant said, *"It is really hard to get your mind around negative rates. What does that even mean? All of the*

conventional wisdom is out the window. What do you do when there are so many products designed in a way that never contemplated this environment and just don't work?" Participants noted the following concerns regarding prolonged low and negative interest rates:

- **Limited returns.** Insurers' present-value liabilities have ballooned, even as the financial returns achievable on investment portfolios have declined. The banking sector's net interest margins have shrunk significantly as rates charged to borrowers have fallen, while rates paid to depositors have stayed above negative levels. Asset managers have suffered from falling fee levels under pressure from investors' heightened price sensitivity and consequent move to lower-cost passive investments. A participant said of banks, *"Business model sustainability is really a question. How do we get to sustainable net interest margins? It is very difficult to have increasing fees in this environment."*

- **Financial instability.** Some participants feared that current non-traditional monetary policy may ultimately lead to bank insolvency and financial instability: (1) as banks' net interest margins become so compressed that lower profitability reduces future capital accumulation and shrinks available credit, (2) as investors reach for yield, pushing asset prices above fundamental values, and (3) as insurers reach systemic levels of insolvency.[24] One concerned director noted, *"There are issues of financial stability for insurance companies, given the liabilities on their balance sheets increasing due to low interest rates. It could endanger the financial system."* And another director observed, *"Everyone believes that rates will rise. It will be the next year or the next year after that. So you keep short duration relative to your liabilities. The problem is we are chasing to get more yield with the accompanying greater risk. That is happening now, and there will no doubt be a correction."*

- **Market distortions.** Extreme monetary policies are also distorting pricing signals in capital markets, directly affecting risk premiums, skewing corporate investment, and creating new sources of financial instability. One participant observed, *"There is evidence to suggest capital markets are not doing the job of old, where they separate the weak from the strong."* As investors have searched farther afield for yield and uncorrelated returns, price levels in many asset classes have shot up relative to foundational value, fueling concern that they are becoming untethered from underlying economic fundamentals. Government capital allocation may be similarly distorted, potentially sowing the seeds of future structural problems in the economy. One participant asserted, *"Governments make appalling decisions on allocating capital because they are making political decisions. We should be concerned by the returns on financial assets and the state of management of these assets."*

Burdensome debt levels are slowing growth and threatening bank stability

Sovereign debt levels have risen significantly in the aftermath of the financial crisis as most developed countries have run much larger fiscal deficits to provide fiscal stimulus during an economically precarious period. The ratios of public debt to gross domestic product in many countries have matched or surpassed historical highs.[25] Private debt levels are also a challenge, particularly in Europe. One participant noted, *"Some studies have concluded that growth rates are reduced by 30% as a result of excessive debt burdens."*

"A 10% deleveraging is estimated to result in a 1% lower growth rate, which in a low-growth environment eliminates all growth quickly."
– Participant

Many outstanding loans are either non-performing, unproductive,[26] or both. Europe's banks have approximately €1.2 trillion ($1.3 trillion) of non-performing loans on their books.[27] At current levels of indebtedness, the traditional remedy of gradual deleveraging through debt service would require very long time horizons and result in depressed growth. One participant suggested, *"A 10% deleveraging is estimated to result in a 1% lower growth rate, which in a low-growth environment eliminates all growth quickly. The alternative is restructuring, but this approach is resisted by the current culture of full debt repayment."* Another participant observed, *"We are stuck in a bad equilibrium. Eight years into the crisis, we are waking up to what we need to do. There has been a lot of action on non-performing loans, but if we are going to address this problem, it needs to be in its entirety."* Some participants suggested politically challenging responses would be necessary to address the problem of non-performing loans in the European banking system: redesigning the solvency system, expanding creditors' rights, or foreclosing on loans, all of which are unlikely in the current political environment.

Geopolitical uncertainty is contributing to questions around global strategies

Current political trends may well make international business more challenging. One business leader observed, "The last three years have definitely been a wake-up call for business on geopolitics … I've not seen anything like it. Since the Second World War, I don't think you've seen such volatility."[28] This volatility has implications for global financial institutions. An executive observed, *"The biggest risk financial institutions, and particularly banks, have always had to manage is geopolitical risk. Banks are actually political institutions, given the role they play in economies. But we only realize that when things go wrong."* A participant said, *"The issues you need to understand now as you set global strategies [are] so broad."* Another observed, *"You can't help but look at the issues that come up on the board agenda through this lens."* This participant pointed out that *"things like compensation, which may serve to underline that sense that we are out of touch, or share buybacks that help the owners but do less to create real value"* could cause a negative backlash in the current political environment.

"How do plans perform in a world where globalization is under threat? Where capital doesn't flow as easily?"
– Participant

Political uncertainty, including questions about the direction of regulatory, trade, and other economic policies, may limit strategic growth options. Boards are questioning assumptions about how business will function: *"How do plans perform in a world where globalization is under threat? Where capital doesn't flow as easily? Where there are significant changes in external environments?"* asked one participant. Technology, once considered a driver of globalization, could also reinforce anti-globalization trends: *"Robotics may mean that rather than employing cheap labor 3,000 miles away, you can use a machine at home. We may see*

countries shut the rest of the world off," observed one participant. Some participants said factors such as cost and compliance risk weighed more heavily on decision making, but one noted, *"It is a question of degree. Would you be expanding into new markets today? I don't think so. But you can't just come and go."*

"There is a different mood in all European capitals. A general sense that the world is now shaping us," observed one participant. Insurgent political parties are gaining increasing influence in mainstream politics, and they are generally *"anti-European, anti-immigrant, anti-US. They like Putin, and they like social conservatism,"* according to this participant. And even where insurgent parties lack direct political power, they have been effective in their ability to "capture the media agenda and challenge the establishment, rather than working within it."[29] As a result, *"Even where they don't win power directly, they are so politically powerful that they are forcing mainstream parties to adopt their positions,"* noted one participant.

"There is a different mood in all European capitals. A general sense that the world is now shaping us."
– Participant

Once-promising emerging markets present heightened political risk as well, meaning there are few bright spots in the world right now. An executive observed, *"The BRICS [Brazil, Russia, India, China, South Africa] have fallen away. It is really the ICS now, and the C is questionable. No one is able to bridge to Africa. You see companies pulling back."* Another said, *"China is the biggest question. China has been a remarkable success story over the last 30 years. But what happens now as they enter the middle-income trap? No country has gotten through that stage without liberalizing. There is no playbook."* Chinese leadership is increasingly authoritarian, and a participant noted, *"East Asia is the part of the world where the defense budgets are going up the fastest. They have highly contested borders and a whole series of nationalist leaders ... There is no immunization against nationalism there."* Russia is increasingly antagonistic toward its neighbors and NATO, and Brazil is dealing with recession and political corruption, prompting one participant to ask, *"What do you make of these economies that were doing well and are now tanking? Brazil is one … They are headed down the road of Venezuela."* A participant predicted that Turkey, another growth market for financial services, *"will cease to be one of the few democratic countries in the region and increasingly look more like a dictatorship."*

A director observed, *"We are in a world where the received wisdom of the benefits of globalization are being challenged in a whole bunch of ways. There is quite a chance that people will think differently about economics as a result. It will affect business."*

"The unthinkable has become conceivable"[30]

Recent events have called into question conventional wisdom and the ability to predict with any kind of precision what may come next:

- **The UK Brexit referendum result.** Surprising pollsters and many political pundits, the UK voted to leave the EU in June, creating uncertainty and ambiguity regarding UK–EU relations for business leaders. Perhaps more worrying is the possibility, suggested by one participant, that *"Brexit is a symptom and an accelerator of a wider trend."* The result in the UK's June referendum was a strong repudiation of "elites," including economists, academics, politicians, central bankers, and business leaders, who all spoke against a vote to leave. It was also a strong call for reduced international integration. A participant said, *"The future of the EU is the bigger factor, which could hurt us much more than just Brexit. We don't know how others in Europe will react."* In fact, in December Italy's Prime Minister, Matteo Renzi, resigned following a constitutional referendum defeat that was widely viewed as a win for populist and Euroskeptic parties who campaigned against him. France, Germany, and the Netherlands all have national elections upcoming in 2017, and others are also considering referenda, which could yield surprises of their own. A commentator recommended, "As long as ideology takes precedent over clear thinking, the risk of a populist government coming to power in France, Holland, or Italy and destroying the EU must be seen as high. Under the current circumstances banks should prepare for the worst, including a major country leaving the Eurozone and the market disruption that would involve."[31]

- **The election of Donald Trump.** At the summit, a geopolitical expert predicted that Donald Trump would not win the November election, but immediately added that his previous predictions about Donald Trump had proven wrong. As with the Brexit vote, the US presidential election results caught most experts by surprise. Another participant asserted, *"The worst case is a Trump election, because what he does will be impossible to predict, and the US would become a major source of instability."* One commentator wrote of a Trump presidency, "The range of outcomes is huge … Extreme volatility is certain."[32] Another commentator noted that Donald Trump "has challenged two of the main bipartisan principles that underpin America's approach to the world. The first is support for an open, international trading system. The second is the commitment to the US-led alliances that underpin global security."[33] At the same time, Trump's proposed policy objectives have given a boost to markets in the US and could lead to additional inflation and interest rate hikes.

> *"Brexit is a symptom and accelerator of a wider trend."*
> – Participant

"The unthinkable has become conceivable" ***contd.***

- **Interest rates dipping into negative territory.** Global interest rates have fallen to levels previously thought unreachable, setting record lows. According to the authors of *A History of Interest Rates,* there have been no instances of negative rates in the past 5,000 years.[34] We have entered uncharted waters. At sufficiently negative nominal rates, institutions could be motivated to place available capital into physical currency, which earns a zero nominal yield above negative sovereign rates. A participant said, *"There is a real question regarding cash guarantees and a zero interest rate: what is the tipping point of negative rates that would push people into cash? We don't know, but it would be damaging for the credit system."*

"In our organization, we are working on the assumption that this low-rate environment will be around for 50 years."
– Participant

Boards are considering appropriate actions amidst extreme uncertainty

The current economic and political situation has ushered in a new level of uncertainty.[35] One participant observed, *"Usually you attempt to measure uncertainty, but when it is so high, it becomes unmeasurable. So, you have to go back to first principles … Form a guess as to what the world looks like, then determine what you want to be prepared for."*

Political uncertainty is impacting personal and business investment decisions, investor confidence, and market volatility. An executive noted, *"The fragility of the market and the political environment are so inextricably linked that politics creates market vulnerability."* In the current environment, another participant noted, *"You see mostly defensive positions being taken in so many industries. It is all cutting costs, which causes a spiral of negativity."*

Participants suggested boards need to consider a broader range of scenarios. A director stated, *"Boards should be vigorously questioning the assumptions built into their planning processes."* It is hard to predict if or when an event-based downturn might occur, or if we can expect a gradual cyclical recovery or decades of low growth. Directors and executives should actively consider multiple possible paths and pressure-test models and strategies for their sensitivities to these scenarios. This acknowledges both the principal source of uncertainty and the consistent forecasting errors of prior models. In particular, institutions may need to consider the possibility that economic growth will not return to recent historic norms and consider certain extreme scenarios as possible. A participant said, *"In our organization, we are working on the assumption that this low-rate environment will be around for 50 years."* Another asked, *"What assumptions are your organizations making about future economic scenarios?"* adding, *"I would bet many are planning for rosy scenarios. You should stress-test some very tough scenarios."*

"It seems the only thing you can do in this environment is take more risks, and no one on the board wants to do that. So, what can we do?"
– Director

A director observed, *"It seems the only thing you can do in this environment is take more risks, and no one on the board wants that. So what can we do?"* One participant's advice was *"to make decisions that are robust, so that [we] can do well in a wide set of circumstances"* – including ones that diverge significantly from historically familiar conditions. Another participant noted the obstacles their institution faced in making some bold decisions following the financial crisis: *"We believed what we had was not a sustainable business model, so we made some major changes. At the time, people thought we were crazy. It was a two-year discussion, a long debate about whether we were seeing structural*

change to the industry or whether it was going to come back." Similarly difficult, fundamental decisions may need to be taken now. A participant said, *"Nothing here is static. We are reexamining product offerings, improving margins by attacking expenses, and reviewing underperforming legacy assets."*

Understanding the structural causes underlying current trends is essential

Given the structural shifts in the global economy and geopolitics, lessons from the past may not be much help in understanding current conditions or the likely path forward. Traditional wisdom would suggest examining the recovery periods of prior recessions and would stress the cyclical nature of economics, in which economies gradually recover through rising consumption, renewed investment, repairing of balance sheets, and growing international trade. But as the last recession fades into the distance, slow growth has continued, along with low labor productivity, lack of investment, and dampened consumption. Equally, the political norms of the last 60 years appear unreliable, as extreme political movements driven by underlying macroeconomic conditions have gained prominence.

Current economic conditions reflect underlying structural shifts

Recent growth forecasts have been based on extrapolating from periods with significant one-time beneficial events. After World War II, these included the growth of international trade, the opening of China and other emerging markets, postwar reconstruction, a general rise in education levels, a significant expansion of consumer credit, and the entry of women into the workforce. Because of this historical grounding, for the last 20 years forecasters have systematically overestimated growth prospects in developed markets. One participant observed, *"Long-term aggregate forecasting errors can become systemic and cumulatively large."* A participant noted that the period of rapid growth after World War II was probably an anomaly that would be difficult to repeat, saying, *"It is not why is growth slowing, but why was growth so strong from the 1950s to 1990s. What was striking was the rapid growth rate in the postwar period. Many of these forces are unraveling."*

> *"Japan in the 1990s was viewed as an anomaly. But it is looking less and less like a special case and more like a blueprint for what is happening now in many places."*
> – Participant

The same participant said, *"I looked for examples of something similar in the past, and there is one story, thought to be unique, that is increasingly relevant: Japan. In the 1990s, very few recognized what was happening or understood what the consequences would be … Japan's stagnation is not a cyclical story. It is a structural story, and you are seeing something similar in other parts of the world … Japan in the 1990s was viewed as an anomaly. But it is looking less and less like a special case and more like a blueprint for what is happening now in many places."*

If organizational leaders mistakenly conclude that the sources of slow growth are largely cyclical in nature and will improve in the near term as economies heal, they will consistently forecast higher longer-term growth than is suggested by the structural underpinnings of the current environment. A participant observed how mistaking the structural changes for cyclical ones can lead to further economic problems, using the example of high debt levels: *"Yes, high debt levels inhibit growth, but we collectively have a debt problem because we have got the growth expectations wrong, and people's incomes were consistently lower than expected."* If leaders assume rates will rise in the near term, they will delay important longer-term responses to economic conditions.

Populist politics are challenging open economic policies

Like the structural forces impacting global economics, the underlying changes in geopolitics are also likely to have a lasting effect. According to one participant, *"What is different today is all these crises are connected and pulling each other down. It may not be the end of the world, but it is likely the end of an era."* Another participant noted the inconvenient truth driving a backlash in Western politics: *"The promise of globalization hasn't been kept. The rising tide lifted some boats; the rest are sinking. I suppose the truer message would have been, 'Some will win, some will lose, but it is going to happen anyway.' Not particularly palatable from a political standpoint."* A combination of developments, most prominently the global financial crisis and the prolonged stagnation in real incomes, are viewed as stark illustrations of the failure of globalization and liberalization – the rules-based system of international trade and investment that has dominated in recent decades – to deliver promised results for large swaths of the population. Monetary policies since the financial crisis have exacerbated inequality by raising the wealth of asset owners without much benefit to the broader economies.

"What is different today is all these crises are connected and pulling each other down. It may not be the end of the world, but it is likely the end of an era."
– Participant

The political response has been shifts to political extremes, both to the left and (even more commonly) to the right, and also a form of populist nationalism that crosses the traditional political spectrum. A participant observed, *"It is out-of-touch elites versus the organized masses instead of left versus right."* The *Economist* described it as "a new political faultline … not between left and right, but between open and closed."[36] Globalization, liberalism, and capitalism themselves are increasingly under attack, and with them, international trade and immigration. A participant said, *"We are living through a counterrevolutionary moment after several decades of the world coming together around support for free trade and the spread of the values of the Enlightenment."*

A participant asserted, *"I think the world has seen the peak of ease of movement of people, capital, and trade. I think trade barriers will increase, subsidies will go back up, and movement of people will go down. Policies will become more extreme left and right. It will get more dangerous. I don't see that stopping."*

Likely policy responses to these trends are limited

A participant said, *"The twin forces of capitalism and democracy have done great things, but they have unleashed some powerful forces of dislocation recently. That is an economic problem, and also a political one, but there isn't the will or ability to address it."* Mohamed el Erian, chief economic adviser at Allianz, and chairman of President Barack Obama's Global Development Council, describes the potentially reinforcing and damaging nature of current economic policymaking thus: "Until recently, the expectation was that if professional economists achieved a technocratic consensus on a given policy approach, political leaders would listen … But after years of unusually sluggish and strikingly non-inclusive growth, the consensus is breaking down … The risk is that, as bad politics crowds out good economics, popular anger and frustration will rise, making politics even more toxic."[37]

"[C]apitalism and democracy have […] unleashed some powerful forces of dislocation recently. That is an economic problem, and also a political one, but there isn't the will or ability to address it."
– Participant

It is inevitable that some countries and regions will recover before others. Monetary and fiscal policies will tighten at different rates, causing volatility in exchange rates, interest rates, and capital flows. Trade and currency wars and precipitating geopolitical events are also possible risks. A participant commented, *"The way that politics is heading could mean that nations are increasingly focused only on their own interests, which could lead to policies that exacerbate the problem."* Another participant noted, *"There is … the potential for currency wars, currency risk. What countries are trying to do with monetary policy could mean we have conflicts between countries and impacts on trade flows."*

Some participants warned that a significant market crisis was possible in the near future. One warned, *"Debt premiums are going up, and people are withdrawing facilities. It is difficult to predict. The market has been in sleepy complacency. It doesn't take much to get into panic overdrive."* Another participant agreed that the risks were great: *"I am very concerned about monetary policy right now. It is so free and easy. If something happens – something we are not really thinking about – it could easily cause a real crisis. It could be an economic event or a geopolitical risk that shocks the system. It would not take much to set off a real panic."*

"The real question is, are low growth rates the result of a structural problem or something that can be addressed relatively quickly by policy?"
– Participant

Governmental ability to respond to either a short-term shock or these longer-term trends is limited. Most available tools for expansionary fiscal and monetary policy are already being used. *"We are facing a conflict between financial hope and economic reality,"* one participant said, noting, *"Monetary policy has led to asset prices being pumped up, but it is not equating to economic growth … So, what are the policy options out there?"* Should a new economic downturn develop, many fiscal and monetary authorities would be challenged to find additional capacity to offset economic weakness. One participant observed, *"There is a real risk of another recession in the coming years. If that happens, there will be real pressure to do something. With rates at zero, what can be done? There will be an increasing need to look at fiscal policy and things like helicopter money.*[38] *The real question is, are [low] growth rates the result of a structural problem or something that can be addressed relatively quickly by policy?"*

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The interdependence of economies and financial institutions makes current macroeconomic and geopolitical trends particularly worrying for leaders. For a small number of higher-probability or higher-severity scenarios, management and the board can develop specific organizational response plans, including liquidity management, capital oversight, client engagement, and regulatory/supervisory engagement. But it is increasingly difficult to predict the probability of different scenarios. As one participant noted, *"It could be something that comes out of the blue that surprises all of us. That is what keeps me up at night."*

With populism increasingly driving politics, constructive engagement between the financial sector, governments, and international policymakers on ways to address these risks is a challenge. Yet it is precisely what is needed. As a participant noted, *"We need people across policy, government, and corporations to try and think through these macro issues."* Otherwise, we may face a vicious cycle in which a prolonged period of low and uneven growth will continue to challenge business models and incite more extreme political

responses. Mark Blyth, a political economist at Brown University, recently asserted, "The global revolt against elites is not just driven by revulsion and loss and racism. It's also driven by the global economy itself. This is a global phenomenon that marks one thing above all. The era of neoliberalism is over. The era of neonationalism has just begun."[39]

Regulatory and supervisory approaches will continue to evolve

> "In light of the rapidly changing environmental conditions – and by these I mean new technologies, new behavioural patterns, new competitors, and new dangers – the question arises for many as to whether the current regulatory approach will still be viable in the future." [40] – Dr Andreas Dombret, Bundesbank executive board member

For the past eight years, the regulatory reform program has primarily focused on ensuring the safety and resilience of the largest and most complex financial institutions. Many of these initiatives started in banking, and similar reforms made their way into insurance and wealth and asset management. These developments have been central to BGLN and IGLN discussions, but now evolving sector dynamics and new political realities are causing a shift in regulatory approaches and priorities.

The regulatory agenda is entering a new phase. As the implementation of ambitious global prudential regulatory mechanisms draws near to completion, conduct supervision is becoming more central to regulatory developments. This is in part driven by political forces. One director summarized, *"[Regulators] had to start with prudential regulation to make sure the system was functional. What we are experiencing now is a shift to what I call consumerism. It is broader than just conduct. It is all about protecting the little guy."* Conduct supervision is also uniquely positioned to adapt to continued transformations in the competitive landscape. In some countries, regulators have an additional competition mandate.

"What we are experiencing now is a shift to what I call consumerism … It is all about protecting the little guy."
– Director

Regulators and supervisors from seven different authorities across North America and Europe participated in the summit discussions, including a session on how regulatory policy and priorities are adapting to a changing competitive landscape. Key themes from these discussions are outlined in the following sections:

- **Supervision and conduct will be at the center of regulatory expansion and adaptation**
- **Questions about the completion of the prudential reform agenda persist**

Supervision and conduct will be at the center of regulatory expansion and adaptation

As with financial institutions, a changing competitive landscape and shifting political dynamics are converging to force regulators to adapt. Indeed, supervisors are shifting their focus from prudential matters towards a more holistic supervisory program, including market conduct, industry culture, individual behavior, governance, and business model sustainability. As they adjust to emphasize these elements and to account for new entrants to the marketplace, regulators and supervisors are rethinking their approaches and considering ways to work with an increasingly diverse mix of players in the financial services arena.

Conduct supervisors, both within stand-alone conduct authorities like the UK Financial Conduct Authority (FCA) or the US Consumer Financial Protection Bureau, and within authorities holding wider mandates, will be the focus of the greatest change. These supervisors are most likely to have oversight of fintech companies and other new entrants because many of these newcomers do not bear prudential risks but do present possible consumer, fraud, or related risks. As one noted, *"We look at new actors and say, 'Are they respecting regulation or trying to bypass it?' But it is not primarily about capital for them. It is anti–money laundering, know your customer, etc."*

"We look at new actors and say, 'Are they respecting regulation or trying to bypass it?'"
– Regulator

The conduct agenda is, in many ways, newer than the prudential regulatory agenda, and supervisors continue to identify ways to offer more direction and clarity on their new approaches for oversight of traditional financial institutions, and to allow for innovation and new competition.

Authorities are experimenting with new approaches to supervision

As authorities pursue new regulatory directions, they are expanding their toolkit. Summit participants highlighted increased engagement and new and experimental structures, particularly those focused on regulation of new fintech firms, as two of the most important novel approaches.

More proactive engagement

Since the financial crisis, supervisors in many countries have sought ways to improve formal and informal engagement with the firms they supervise to improve communication and provide a mechanism for identifying risks earlier. *"We have an increasing focus on the anticipation of problems,"* a supervisor said. *"We are trying to get to the whispers before they turn to screams. We have a huge focus on understanding business models and how you go about competing."* The massive fines incurred by financial institutions for misconduct have garnered a lot of attention, but regulators generally acknowledge the need to identify potential problems earlier and intervene before misconduct occurs. In addition to individual firm engagement, there are also industry-wide efforts. For example, the Federal Reserve Bank of New York has been hosting an annual conference on culture since 2013 to engage policymakers and financial firms on best practices to address conduct and cultural challenges in the sector.[41]

"We have an increasing focus on the anticipation of problems. We are trying to get to the whispers before they turn to screams."
– Supervisor

Industry participants welcomed these steps and encouraged improved communication and more predictability. A supervisor responded, *"We agree. The solution is more supervision and more dialogue. You might not like the answer, but we are trying to be as predictable as possible."* But most supervisors hesitate to go so far as to defining "best" or even "good" practice. One explained why: *"We are not consultants, so we are not trying to consult or provide metrics … I know it is frustrating as a regulated institution not to get advice regarding what the supervisor deems good practice. Sometimes industry is crying out for guidance, but that requires interpretation, which equals expectations, which equals guidance, and guidance requires formal consultation."* This supervisor emphasized engagement over rules, saying, *"We have two options regarding the role of supervision: (1) We can look at practices across the market and develop new rules; or (2) we can go out and talk to firms and see what makes sense."*

New structures for experimentation

Regulators are designing strategies that balance keeping the economy safe with encouraging innovation, such as the UK FCA's "regulatory sandbox," which allows innovative firms to test out new business models in a controlled environment without incurring the normal regulatory consequences of engaging in particular activities.[42] The Australian Securities and Investments Commission and the Monetary Authority of Singapore have also established regulatory sandboxes.[43] In addition, Switzerland recently announced a new fintech licensing regime that would free companies in the sector from the regulatory burdens facing banks.[44] One supervisor commented, *"In general, we are keen on innovation and seek ways to avoid stifling it."* While participants agreed that these initiatives may boost innovation and competition, some warned about developing an unlevel playing field or even creating new sources of instability. Supervisors acknowledged these concerns and emphasized there would be no dilution of standards for the new entrants. The supervisors stressed that their goal is to reduce pain points and to streamline regulatory processes for start-ups and incumbents alike on things like due diligence for new products.

"We are keen on innovation and seek ways to avoid stifling it."
– Regulator

Regulatory authorities face numerous challenges in modernizing supervision

Despite progress, many industry participants remain skeptical that policy and regulation can adapt fast enough to keep pace with market changes. One policymaker said, *"I suspect the supervisory changes will be evolutionary, but it may require a revolution to do it well."* Participants noted several reasons why supervisors are slow to adjust their approaches:

- **They are limited by mandate.** Regulators' and supervisors' ability to expand their scope is limited by law. Even conduct regulators, who have the greatest flexibility and a broader mandate, often face difficulties. *"The borderline between regulated and unregulated activity is a real issue. Innovation creates real perimeter issues. We are starting to see a blurring of models in order to be on the right side of the regulatory line,"* commented one supervisor. One potential solution is to separate entities into two buckets: *"If you are big and important, then we will create a perimeter and create rules. If not, we will focus on fit and proper, and culture,"* suggested one supervisor.
- **Technological changes require supervisors to acquire new skills.** One participant commented, *"My feeling is that regulators feel absolutely uncomfortable dealing with the technological environment. They are trying to learn, but they are not ready."* Another participant summarized the challenge: *"Regulators absolutely know that technology is a key component, and it will differentiate the industry. They get that, but have no idea how to supervise it. They have the wrong skill set as regulators."* Supervisors are competing for the same pool of experts as the fintech firms and financial institutions. *"It is a heavy burden, competing on talent with the industry,"* said one supervisor. While supervisors recognize the need to improve their technological expertise, participants also emphasized the importance of continuity and stability in supervisory teams to ensure continued understanding of business models and how the technology is being applied.

"I suspect supervisory changes will be evolutionary, but it may require a revolution to do it well."
– Supervisor

- **Financial technology companies are unprepared for regulation.** A compliance attorney described the attitude toward regulation among some in the fintech community as *"willful ignorance."* Many fintech firms lack the knowledge to effectively engage with traditional modes of supervision. *"Technology firms also need new skill sets to understand financial services. They are a bit clueless at the moment,"* said a supervisor. Another added, *"Many companies want to be compliant, but they don't know how. They know nothing about financial services, but they are quick learners. The question is, what do we do as supervisors to support that journey? Is there more we should do?"*

"Technology firms also need new skill sets to understand financial services. They are a bit clueless at the moment."
– Supervisor

- **The increased use of third-party providers complicates supervision.** More and more, regulated financial institutions are outsourcing to third-party providers and are partnering directly with fintech firms. The relationships can make financial institutions vulnerable in new ways, as when broken linkages between BNY Mellon and SunGard led to BNY Mellon's inability to price assets accurately.[45] One regulator commented, *"We can talk about new entrants, but another large group that has interdependence with all large financial institutions is service providers. There are critical linkages to certain products. My view is we need more attention for these entities."* In a July interview, Tracy Basinger, group vice president of Financial Institution Supervision and Credit at the Federal Reserve Bank of San Francisco, stated, "Almost every one of these companies has a bank partner at some stage of the process. Since we regulate those banks, it's important that we understand what those partnerships look like and the implications for banks and consumers."[46] For the most part, supervisors rely on supervised firms to exercise judgment and to ensure proper controls are in place. However, some regulators are keen to understand how relationships and partnerships are developing and the risks they may present.

Regulation and data analytics

One particular development that will impact supervision is the use of advanced data analytics. Especially for insurers, recent advancements in analytics are enabling different customer behaviors and new types of products and services. Some participants posit that developments will have adverse effects, such as financial exclusion or loss of privacy. A regulator said they worry that *"more data means more discrimination. We worry about exclusion, but it is not part of our mandate to fix it. We point to it and say, 'Look, this is happening,' but it is not for us to deal with it."* A director commented, *"Regulators talk about data a lot. But I would say there is no perceived need for regulatory action yet."*

Despite this current wait-and-see attitude, most participants agreed with the regulator who predicted, *"Regulation is coming, but we are still governing by rules that are obsolete. We have no rules on what is the right data usage, but there is no doubt the government needs to put some limits."* Recent comments by Andrew Bailey, chief executive of the FCA, suggest regulators may take additional action to ensure customers are not exploited.[47]

"We have no rules on what is the right data usage, but there is no doubt the government needs to put some limits."
– Regulator

Conduct risk will remain a priority for boards

Minouche Shafik, deputy governor of the Bank of England, recently highlighted the accumulated fines levied on banks for past misconduct: global banks' legal costs since 2008 now exceed $275 billion, which translates, she suggested, to $5 trillion of reduced lending capacity.[48] One participant quipped, *"The greatest risk to financial stability is now the US Department of Justice."*

A number of recent high-profile scandals virtually guarantee that banks and insurers will continue to experience pressure and risks to their reputation and brand from misconduct. *"What happened at Wells Fargo further pushed down trust and respect,"* said one director. *It will take longer to recover from this than it would from a rogue trading incident because this the average person understands."* Industry participants agreed that the financial sector will need to respond in both an individual and collective fashion, as noted below:

- **A renewed emphasis on non-financial risk.** One director commented, *"As a risk committee chair, it is fairly straightforward to look at fiduciary risk, market risk, etcetera. We spend more time on conduct and culture because it is the operational and conduct risk that could bring down a bank in today's environment."* Another added, *"Compliance risk has to be the number one risk to stability. Institutions need to think about how practices will be seen in retrospect."*
- **An increased focus on individual accountability.** Recently, there have been moves to increase individual accountability for bank and insurance conduct. The UK's Senior Managers Regime holds banking executive and non-executive directors explicitly accountable for boardroom decisions.[49] An EY analysis concluded that bank leaders "need to show increased understanding of key business and strategic activities, and their associated risks."[50] The UK's Senior Insurance Managers Regime plays an equivalent role, identifying key senior insurance management functions and assigning responsibility for these activities.[51] Beyond these formal accountability regimes, informal public pressure for greater accountability and responsiveness also is having an effect, as demonstrated by the recent resignation of Wells Fargo CEO John Stumpf.[52]
- **More sector-wide collaboration.** A participant observed, *"There is no trust … but there is a reason for that. I suspect companies and the sector will need to spend a lot of time and effort rebuilding goodwill."* Although part of the response will be simply to avoid major scandals, participants agreed the reputation challenge extends to the industry as a whole. Firms are therefore exploring collaborative efforts on things like industry utilities that improve anti–money laundering efforts and know-your-customer compliance, and some have called for a registry of bad actors so that firms can avoid hiring people who have committed misconduct.[53]

"Compliance risk has to be the number one risk to stability. Institutions need to think about how practices will be seen in retrospect."
– Director

"There is no trust … I suspect companies and the sector will need to spend a lot of time and effort rebuilding goodwill."
– Participant

Questions about the completion of the prudential reform agenda persist

In a recent speech, Sam Woods, chief executive officer of the UK Prudential Regulation Authority, stated, "We have reached the end of the revolutionary period in which major reforms to prudential standards were required in response to the 2008 financial crisis."[54] Yet, even as the prudential reform agenda comes to a close, there remain some outstanding

implementation questions that could have significant implications. A regulator noted, *"I don't see a whole load of new policy initiatives out there that are coming. The direction of travel has been agreed to, but many of the reforms have yet to be implemented."*

"The direction of travel has been agreed to, but many of the reforms have yet to be implemented."
– Regulator

Participants identified the following activities as among the most significant remaining regulatory actions:

- **The Basel Committee is finalizing rules that may profoundly impact capital levels for banks.** While international capital guidelines under Basel III have been agreed to for some time, requirements are still being finalized for the largest banks. The Basel Committee is currently reviewing rules for the calculation of risk-weighted assets, as well as new rules on operational risk and loan treatments, which could have a significant impact on total capital. Some have predicted that the combination of these rules changes means "Basel IV" is coming.[55] One director commented, *"More and more capital requirements are being loaded on."* An executive added, *"The key issue is still the push from regulators to increase capitalization when the economies are just not able to generate sustainable earnings."* International discussions are potentially moving in a less burdensome direction as policymakers take into consideration relevant trade-offs.[56] Still, proponents of the rule changes, including Daniel Tarullo of the US Federal Reserve, emphasize that the rules are important in combating regulatory arbitrage[57] and insist that this exercise was not about raising capital requirements.[58]
- **An international capital standard for insurance is moving forward.** The International Association of Insurance Supervisors (IAIS) is in the process of developing the first international capital standard for insurance groups. The insurance capital standard (ICS) will apply only to the roughly 50 largest groups. While progress on the ICS has slowed somewhat, the IAIS plans to finalize a "Version 1.0" by 2017, to be followed by adoption of a 2.0 framework in 2019.[59] Participants noted multiple concerns regarding the ICS, including that it would be a poor fit for certain local markets and that it might have unintended consequences – such as adverse product and pricing outcomes for consumers. Several IGLN participants argued that burdensome capital levels would blunt the industry's important role as a countercyclical agent in financial markets.

"Now, after completing much of the G20 regulatory agenda, we are seeing all that has been done is having a profound impact on the shape of the financial sector."
– Director

Pressure to address regulatory trade-offs will likely intensify creating additional uncertainty

In a network conversation earlier this year, a director said, *"Now, after completing much of the G20 regulatory agenda, we are seeing all that has been done is having a profound impact on the shape of the financial sector. We need to stand back and see what it has wrought."* Though most summit participants acknowledged that many of the reforms were necessary and created a safer financial sector, some suggested that fault lines on issues like economic growth, competition and global regulatory convergence will intensify in the coming years. Participants cited the following policy debates as most critical:

- **Supporting economic growth versus maintaining strong prudential controls.** In August, Barclays CEO Jes Staley warned, "If you look at the top 12 banks across Europe, on average they're trading at about a 50 percent discount to book value. That's not healthy for the financial system, that's not healthy for the European economy."[60] Some participants suggested that regulators may need to recalibrate their

approach, especially in Europe where the financial sector continues to struggle against headwinds of low inflation, low interest rates and, in some countries, huge stockpiles of non-performing loans. One executive asked, *"What does it really mean to have a financial sector with such a high level of capital?"* Participants expressed concern that attempts to drain all the risk out of the financial sector are limiting the ability of economies to grow. Furthermore, some critics contend that increased capital levels don't necessarily reduce sources of instability. One participant commented, *"Yes, there is far more capital – six to eight times as much equity capital today – but we have lifted the floor at which it bites, at which there would be a market or regulatory reaction. So, I'm not sure it's that much more stable."* Another added, *"The secondary effect of the high cost of capital is that it creates the new shadow players. There is little discussion of the risks this creates, and there should be."* With these concerns in mind, banking and insurance experts are urging regulators to revisit the unintended impacts of new prudential regimes.[61] A regulator acknowledged, *"We may have pushed too far on capital and liquidity, and now some don't like the consequences. That emphasizes the importance of supervision, which can be flexible, over more rules."*

"What does it really mean to have a financial sector with such a high level of capital?"
– Participant

- **Boosting competition versus ensuring stability.** In addition to protecting the financial system and its integrity, several national regulators are also mandated to increase competition. Here too, participants warned of possible unintended consequences. *"We learned that from a safety-and-stability perspective, you want a well-managed oligopoly. Competition authorities want more access for challengers. These are somewhat competing goals. At some point, the competition authority thought process runs counter to the prudential strategy,"* observed one. Indeed, a recent study comparing Australia and Canada's handling of the financial crisis with that of the US and UK suggests that competition can be a "vice as well as a virtue" and that the regulatory assumption that competition is good needs to be examined.[62]

- **Global regulatory harmony versus a nationally sensitive approach.** Both insurance and banking supervisors highlighted the delicate balance between achieving global regulatory convergence and meeting the needs of local markets. Many participants see signs, however, that regulation is again becoming divided across jurisdictions. *"There will be a shift in the policy world. It feels more like a standoff of regulators. Some will go for more caution versus others who continue gold plating,"* warned an executive. Already, some geographies are pushing back on global rules, arguing they create an unlevel playing field. John Cryan, CEO of Deutsche Bank, recently stated, "I think it's about time that Europe started introducing rules that benefited Europe and didn't play to some policy of global harmonisation that sounds good on paper, but is not relevant to anything."[63] These sentiments are even now reaching many politicians as the European Parliament recently announced their opposition to the current form of Basel negotiations on the grounds of their potential impact on European banks.[64] A director observed, *"Political forces could potentially result in a balkanization of the regulatory environment. Firms won't welcome that. The one thing firms fear more than regulation is uneven regulation."*

"The one thing firms fear more than regulation is uneven regulation."
– Director

Recent political developments may upend prudential regulatory agendas

Political populism, which has been on the rise, targets large financial institutions for particular criticism. Even before the surprise result of the US presidential election, summit participants expressed concerns that political volatility could result in persistent regulatory uncertainty. Few thought financial services would benefit. One said, *"It will be a long time for financial institutions before politicians come down positively publically on all of us."* Another added, *"There is a piling-on effect. Nobody is criticized for expecting more and more from us. You lose no political capital by upping your game."*

Following the US elections and the fallout from Brexit, some industry participants are expressing optimism that the regulatory pendulum may be swinging in a new direction, as evidenced by the recent surge in financial–sector stocks. In the United States, the president-elect has stated his support for unwinding financial regulation and in particular his desire to roll back many of the Dodd-Frank reforms. In the United Kingdom, some commentators are hopeful that the recent shift away from the post-crisis regulatory crackdown on big financial institutions and toward a more balanced approach will accelerate following Brexit.[65] Elsewhere in Europe, policymakers eager for growth are starting to sound more conciliatory toward the financial sector.

"There is a piling-on effect. Nobody is criticized for expecting more and more from us. You lose no political capital by upping your game."
– Director

Still, many experts doubt that the regulatory environment will change overnight, and some note that not all changes may be positive. Financial deregulation may not be a core strategic priority for a White House and Congress focused on Supreme Court nominations, energy policy, healthcare, immigration, and foreign trade.[66] Furthermore, changes to financial regulation will require slowly rolling back rules that took many years to develop. Attempts to unwind regulation are likely to face local challenges from some constituencies, as well as international challenges should they contravene international agreements. A participant observed, *"Because of Brexit, some European countries could try to compete based on regulation, softening local capital requirements."* But a regulator stated, *"We have to be trusted to be objective in the face of political pressures."* In the end, even if some jurisdictions move toward greater leniency for the financial sector, populist pressure across the globe will likely limit the reprieve.

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Jaime Caruana, the general manager of the Bank for International Settlements, recently commented, "A consensus is emerging that technology-driven change is inevitable, and that it brings with it massive potential for disruption. I believe this will be an overall positive development, although the final balance will depend on, among other factors, how the authorities respond – both at the domestic level and the global level."[67] Policymakers face the unviable task of ensuring the causes of the last crisis do not reemerge while at the same time being proactive in the context of an evolving sector. The challenge for regulators and supervisors will be effectively managing these regulatory transitions despite uncertainty both in the sector and in national and international politics.

About the Financial Services Leadership Summit (FSLS)

The FSLS is an annual meeting addressing key issues facing leading financial institutions. It brings together non-executive directors, members of senior management, policymakers, supervisors and other key stakeholders committed to outstanding governance and supervision in support of building strong, enduring and trustworthy financial institutions. The FSLS 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 FSLS discussions 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 multistakeholder 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 insurance 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 FSLS as part of its continuing commitment to board effectiveness and good governance in the financial services sector.

Appendix: summit discussion participants

In 2016, Tapestry and EY hosted nine BGLN and IGLN meetings, including the first Financial Services Leadership Summit. In preparation for the summit, Tapestry and EY had more than 80 conversations with directors, executives, regulators, supervisors, policymakers, and other thought leaders. Insights from these discussions helped to shape the summit agenda and inform the enclosed *ViewPoints* documents.

The following individuals participated in discussions for the 2016 Financial Services Leadership Summit:

Directors

- Sue Bies, Non-Executive Director, Bank of America; Risk and Investment Committee Chair, Zurich Insurance Group
- Lord Norman Blackwell, Chairman, Lloyds Banking Group
- Paul Bradshaw, Non-Executive Director, Sanlam
- Philip Broadley, Audit Committee Chair, Legal & General
- Pat Butler, Non-Executive Director, Bank of Ireland
- Marcia Campbell, Non-Executive Director, CNP Assurances; Non-Executive Director, Sainsbury's Bank
- Jan Carendi, Senior Advisor, Sompo Japan Nipponkoa
- Lawrence Churchill, Risk Committee Chair, Bupa
- Sir Sandy Crombie, Performance and Remuneration Committee Chair, Royal Bank of Scotland
- Sir Howard Davies, Chairman, Royal Bank of Scotland
- John Fitzpatrick, Risk and Capital Committee Chair, AIG
- Crawford Gillies, Remuneration Committee Chair, Barclays
- John Green, Deputy Chairman, QBE Insurance Group
- Sara Grootwassink Lewis, Non-Executive Director, Sun Life
- Byron Grote, Non-Executive Director, Standard Chartered
- Noël Harwerth, Non-Executive Director, Standard Life
- Mike Hawker, Risk Committee Chair, Aviva; Remuneration Committee Chair, Macquarie
- Cathy Kinney, Non-Executive Director, MetLife
- Jean-François Lepetit, Internal Control, Risk Management and Compliance Committee Chair, BNP Paribas
- Monica Mächler, Non-Executive Director, Zurich Insurance Group
- Mike Martin, Audit Committee Chair and Risk Committee Chair, Euroclear
- Richard Meddings, Audit Committee Chair, Deutsche Bank; Non-Executive Director, Legal & General
- John Misselbrook, Chairman, Aviva Investors Holdings
- Scott Moeller, Risk Committee Chair, JPMorgan Securities
- Nathan Moss, Non-Executive Director, Canada Life; Non-Executive Director, One Savings Bank
- Tony Neoh, Risk Management Committee Chair and Compensation Committee Chair, ICBC
- Andrew Palmer, Audit Committee Chair, Direct Line
- Nick Prettejohn, Non-Executive Director, Lloyds Banking Group; Chairman, Scottish Widows
- Sabrina Pucci, Non-Executive Director, Assicurazioni Generali
- Nathalie Rachou, Risk Committee Chair, Société Générale
- David Roberts, Chairman, Nationwide Building Society
- Barry Smith, Non-Executive Director, Ageas UK, Portugal, Turkey, Italy
- Kory Sorenson, Audit Committee Chair, SCOR

- Doug Steenland, Chairman, AIG
- Bob Stein, Non-Executive Director, Aviva
- Jim Sutcliffe, Chairman, Sun Life
- Ron Teerlink, Chairman of the Board, Rabobank
- Tom Woods, Non-Executive Director, Bank of America

Executives

- Giles Andrews, Co-Founder and Executive Chairman, Zopa
- Domingo Armengol, Corporate Secretary and Secretary of the Board of Directors, BBVA
- Anthony Baldwin, Chief Executive Officer, AIG UK
- Jason Brown, Chief Risk Officer, QBE Insurance Group
- Christa Davies, Chief Financial Officer, Aon
- Sally Dewar, Head, Regulatory Affairs Europe, JPMorgan Chase
- Sue Kean, Chief Risk Officer, Old Mutual
- Axel P. Lehmann, Chief Operating Officer, UBS
- John Levin, Founder and Director, Quanis; Chairman, Rocketer
- Stuart Lewis, Chief Risk Officer, Deutsche Bank
- Steven Mendel, Chief Executive Officer and Co-Founder, Bought By Many
- Mark Mullen, Chief Executive Officer, Atom Bank
- Lewis O'Donald, Global Chief Risk Officer, Nomura
- Nick Silitch, Chief Risk Officer, Prudential Financial
- Raj Singh, Chief Risk Officer, Standard Life
- Alan Smith, Global Head of Risk Strategy, HSBC
- Stan Talbi, Chief Risk Officer, MetLife
- Tom Williams, Chief Executive Officer and Co-Founder, Certua
- Tom Wilson, Chief Risk Officer, Allianz

Regulators and Supervisors

- Sandy Boss, External Member, Prudential Regulation Authority Board, Bank of England
- Jonathan Davidson, Director of Supervision, Retail & Authorisations Division, UK Financial Conduct Authority
- Patrick Montagner, Deputy Secretary General, General Secretariat, ACPR
- Florian Narring, Principal Supervisor, DG Micro-Prudential Supervision I, Division 2, European Central Bank
- Fausto Parente, Executive Director, EIOPA
- Bertrand Peyret, Director of Insurance Supervision, ACPR
- Bruce Richards, Senior Vice President and Head of the Complex Financial Institutions Group, Federal Reserve Bank of New York
- Michael Schoch, Head of Banks Division, Swiss Financial Market Supervisory Authority
- Elisabeth Stheeman, Senior Advisor, Prudential Regulation Authority, Bank of England
- John Sutherland, Senior Advisor, UK Financial Conduct Authority

Other Experts

- Ewen Cameron Watt, Senior Director, BlackRock Investment Institute
- Maria Demertzis, Research Fellow, Bruegel
- Stephen King, Senior Economic Advisor, HSBC
- Mark Leonard, Director, European Council on Foreign Relations

EY

- Omar Ali, Managing Partner, UK Financial Services
- Martin Bradley, Partner, Global Insurance – Finance, Risk, and Actuarial Leader
- Shaun Crawford, Global Insurance Leader
- Carmine Di Sibio, Global Managing Partner, Client Service
- Imran Gulamhuseinwala, Global FinTech Leader
- Dave Hollander, Global Insurance Advisory Leader

- Tom Huertas, Partner, Chair of Global Regulatory Network
- Alison Kay, Global Vice Chair, Industry
- Kevin Koenig, FS Global Insurance Data and Analytics Leader
- Mike Lee, Global Wealth and Asset Management Leader
- John Liver, EMEIA FS Regulatory Compliance Leader
- Marcel van Loo, EMEIA FSO Regional Managing Partner
- Roger Park, Partner, FS Strategy and Innovation
- Andrew Parton, Global Client Service Partner, Insurance
- Isabelle Santenac, EMEIA FSO Assurance Managing Partner
- John Santosuosso, Global Insurance Assurance Leader
- Bill Schlich, Global Banking and Capital Markets Leader
- Roy Stockell, EMEIA Wealth and Asset Management Leader
- John Weisel, Banking and Capital Markets Advisory Sector Leader
- Simon Woods, EMEIA Insurance Optimization Lead
- Jonathan Zhao, Asia-Pacific Insurance Leader

Tapestry Networks

- Dennis Andrade, Partner
- Leah Daly, Principal
- Jonathan Day, Vice Chairman
- Colin Erhardt, Associate
- Peter Fisher, Partner
- Craig Kennedy, Senior Advisor

Endnotes

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[2] *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.

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