Financial institutions are accelerating investments in tech transformation

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>
> – Venture capitalist

Fintechs and large technology companies have been making forays into financial services for some time, and customers increasingly expect digitalized, automated, real-time service. This is forcing large banks and insurers to invest heavily in their own digital capabilities to keep pace. As one venture capitalist said, *"No part of the financial services value chain is immune from the impact of technology, and no business lines are immune. We see opportunities across all business lines and across the value chain."* Financial institutions are now spending billions annually to upgrade core systems and invest in expanding technology applications, including cloud services and artificial intelligence (AI).

At the Financial Services Leadership Summit on June 8–9 in New York, directors and executives from large financial institutions, regulators, and other subject matter experts discussed the ongoing imperative for digital investments to improve their ability to meet evolving customer needs, as part of a broader agenda about how financial institutions are meeting heightened stakeholder expectations. Summit participants were joined by Howard Boville, head of IBM Cloud Platform, and Carlos Gutierrez, CEO of Empath and non-executive director at MetLife. This *ViewPoints* synthesizes discussions held in advance of and during the summit and is structured around the following themes:[1]

- **The need to serve customers in new ways is driving technology investments**
- **Firms are navigating investments and risks with cloud computing and AI**

The need to serve customers in new ways is driving technology investments

Industry leaders stress that technological innovation is crucial to enabling their businesses to become more customer-centric. One participant observed that everyone is struggling to answer a common set of questions: *"How quickly can we innovate for customers and spin up and roll out new products* *with our existing systems? How can we anticipate customer needs, and what's our data strategy around that?"*

Summit participants discussed several key ways financial institutions can better serve their customers:

- **Simplifying financial products.** One insurance participant noted, *"We are seeing changing client expectations; it's clear that clients want simpler insurance products."* A director agreed: *"We have to move to relatively simple products. Especially for the mass market, the industry has to simplify products and reduce 20 options to something more understandable. Complexity is a huge barrier."*

"For competitive advantage now, products are secondary; what is primary is the frictionless experience you can provide your customers."

– Executive

- **Creating a more seamless customer experience.** Improving the customer experience may be more important than product innovation. *"For competitive advantage now, products are secondary; what is primary is the frictionless experience you can provide your customers,"* an executive said. *"We are all conditioned by our devices to have a need for instant gratification. Anything that introduces latency will turn customers off."* To date, much of the attention has focused on the consumer space, where there is increasing competition from new entrants. Some believe the commercial and corporate space will come next. One industry expert said, *"The proliferation of digital interactions on the consumer side has filtered into the commercial side. We see expectations for digital interactions bleeding into the commercial side."*
- **Digitalizing distribution channels.** Technology investments can empower new ways to reach customers. Digital distribution channels have the potential to expand product penetration among younger customers—so-called digital natives—who are at home in online environments. Embedding financial products with other products and services is also an increasingly important distribution channel, as one insurance executive pointed out: *"Customers are ready to buy insurance products through noninsurance brands."*

Moving on from legacy systems

Reshaping the customer experience, however, *"puts a lot of pressure on legacy systems."* Participants pointed out that legacy systems organized around existing products limit financial institutions' ability to develop new products, assess and meet customer needs holistically, and simplify the customer experience. Addressing these limitations requires investments across the technology stack, not just developing new front-end technologies. One participant said, *"You can only generate that frictionless customer* *experience by building from back to front, upgrading core business processes, etcetera. If you do that, you can have a successful business transformation strategy. You need to be obsessing about time, how long it takes to do a thing or a series of things within the institution."*

And yet, the costs and risks associated with upgrading core systems are substantial. Most institutions take a gradual approach, starting with a single product or group of related products and running some on the new system while retaining most of the old core. Others launch a greenfield operation for a digital product on a new platform rather than migrating the entire technology stack. One executive said, *"We're seeing fewer big IT transformation products. There are fewer of the big replatforming projects and more tactical approaches where the organizations add a digital layer onto legacy rather than big system transformation that takes years and can be outdated by the time it's finished."*

"The notion that cloud is a cheaper way to run IT is a fallacy. The real thing is that it is a digital tool for digital strategy."

– Participant

Assessing technology investments

Participants suggested that while technology investments can improve efficiencies, their value lies not primarily in cost savings but in improving operational capabilities and driving business strategy. One participant said, *"The notion that cloud is a cheaper way to run IT is a fallacy. It was positioned that way, but that's never been the promise. The real thing is that it is a digital tool for digital strategy. It's a technology, but it has to be driven by the business."*

Boards can be challenged in evaluating the returns on technology investments, which often require significant capital expenditures but may only realize benefits over the long term. The scope and scale of these projects makes evaluating their returns using traditional approaches difficult. An executive advised, *"From an IT perspective, measurements have to be simple: Are we improving productivity and generating operating leverage? What value are we creating with these investments that differentiates us?"*

Firms are navigating investments and risks with cloud computing and AI

The leaders of financial services firms are exploring investment in a host of technologies to help transform their businesses. Some of these technologies are proven, while others are still in their nascent stages or only now scaling up in the industry. To date, cloud computing platforms and AI/machine learning have demonstrated the most potential to fundamentally change how large banks and insurers interact with their customers and do business.

Cloud adoption will be central to technology upgrades

Leaders of financial institutions agree that a move from legacy mainframe systems to cloud platforms is inevitable. Migrating to the cloud can unlock new ways of managing and analyzing data, improve overall speed and agility, upgrade security, advance compliance and fraud management, and ultimately result in cost savings and revenue growth through improved customer experience. Even those firms that were once reluctant to move to the cloud are now doing so as quickly as they can. “If there was any doubt America’s biggest financial institutions are ready to embrace and invest in cloud technology this year, it’s gone,” a recent report of cloud adoption in the financial sector noted.[2] One insurance director said, *“The move to the cloud is not optional.”* An executive warned that those that delay *“are at risk of getting completely trapped”* in legacy technology.

> *“Data is your existential threat, so you have to be careful who you give it to.”*
>
> – Participant

Cloud security and resiliency considerations

Security and resiliency are key considerations for organizations, boards, and regulators in assessing cloud strategies. One participant stressed that boards need to ask how they *“can demonstrate business resiliency, including to third- and fourth-party risk; often, it’s a retrofit rather than built in at the front.”*

Cloud adoption also raises concerns about concentration risk, both for individual firms and the system as a whole: *“Do we really want all of our data to be in the hands of four or five companies around the world?”* One participant noted, *“All regulators require you to be able to demonstrate that in the event of catastrophic failure, you can restore mission-critical business processes. You have to demonstrate the ability to restore processes in a meaningful time frame so as not to introduce systemic risk.”*

Concerns about data ownership and residency

Ownership and residence of data is also a crucial consideration in adopting cloud technologies. One participant said, *“Data is your existential threat, so you have to be careful who you give it to.”* Some cloud providers require that data run on their computers in their data centers, and it might prove difficult or costly to switch cloud providers. Others, an executive cautioned, *“have DNA that wants to make money from data,”* questioning whether and how they might use financial institution data for other purposes. The same participant said that despite the cloud providers storing the data, they will not take accountability for it: *"Anything that happens on the platform is your responsibility. They’ll say, ‘It’s your responsibility if anything goes wrong and we’ll issue a press release to that effect.’"*

Control over data raises strategic issues as well. To derive maximum value from their data, financial institutions may *"want to work with third-party sources and mix data with other data sets in order to drive insights. Once you give it to someone else, it can be difficult to do that. In the boardrooms, we need to be asking, What is the thought process around our most valuable asset?"*

Geopolitics also factor into cloud-migration strategies. One participant noted, *"The world is getting more complicated from a regulatory perspective. There are conflicting and toxic combinations of regulations. It's happened with the move from globalization to nationalizing; there's a political agenda around data residency—the sovereign cloud—and that adds complexity and tripwires that give you no competitive advantage."* An executive added, *"The data sovereignty piece is becoming more important, and regulators are asking about this."*

Adopting a cloud strategy

"Have decisions about [cloud suppliers] been made based on any strategy or just because certain people fancied certain pieces of software?"

– Participant

In the face of such concerns, getting the cloud strategy right becomes critical. *"Cloud is a tool, and how you select the right tool is essentially important, especially for regulated institutions,"* one executive noted. Many large banks and insurers often look to hybrid cloud or multicloud approaches, but a participant cautioned against creating "Frankenstein architectures" piecing together legacy and modern systems. Another participant said, *"A hybrid approach, with data both on premises and off premises, can give you a level of resiliency. That's often not factored into decisions, and people will say, 'Let's sign a big contract with your cloud provider and move all our stuff to the cloud.'"* Instead, this participant suggested, financial institutions need to consider not only which cloud providers to use or what to move to the public cloud, but also where mainframes remain essential and ensure they are getting the benefit of new mainframe capabilities thar offer similar benefits to those offered by cloud.

Even in a multicloud environment, summit participants noted that a given product, service, or business product might still reside with a single provider: *"Different bits of the organization may be working with different providers, so you may have concentration in segments [even though] you might not have organizational concentration risk."* To get comfortable that the organizational approach to cloud makes sense, a participant suggested that boards ask, *"What does the map of cloud suppliers look like across the organization? Have decisions about that been made based on any strategy or just because certain people fancied certain pieces of software?"*

Despite concerns, AI and machine learning are gaining acceptance

AI and machine learning have the potential to dramatically affect an array of business and internal applications, and incumbents face competitive pressure to advance implementation. According to the *Wall Street Journal*, "Fintech and big technology companies could outpace traditional banks in the race to develop AI tools that help personalize services, evaluate credit risk and more."[3] One participant said, *"I think you can 100% sit out of crypto or some of these other hyped trends, but I do not think you can sit out of AI or machine learning entirely, because you risk missing out on the future of the industry."*

One area where summit participants see real potential for AI is in helping to address talent concerns in the industry. While large banks and insurers have been using rudimentary AI for resume scans for years, a director said, *"it's not representative of what AI can do today."* Participants discussed how the technology can now be used to more effectively identify and catalog skills across entire organizations, measure soft skills like ambition and courage, and chart career paths within firms that may not be intuitive to employees or their managers. A participant noted that AI enables firms to *"pinpoint what people need so every person in the company has their own development plan."* *For more about how firms are applying emerging technologies to talent issues, see the companion ViewPoints entitled "Attracting and retaining talent amid generational and market changes."*

"You can do things badly quickly and at scale with AI and create tools of mass destruction."

– Participant

Despite AI's potential to help transform not just talent management but also other operations across financial institutions, concerns about lack of transparency and bias give organizations and their boards pause in adopting AI technologies. AI and machine learning applications can represent a black box that is difficult for laypeople, and sometimes even technical experts, to understand and explain. In a prior network discussion on AI, a director said, "There's a danger with AI that the machine develops its own way of thinking that is not necessarily clear and cannot be easily explained to the customer."[4]

Bias is not unique to AI: one participant pointed out that *"the biggest bias machine is a human being."* However, encoding bias into AI models risks magnifying it to an unprecedented scale. One regulator asked, *"Are you allowing systematic bias into decision-making in an industrialized way? Getting everything wrong rather than everything right?"* Another participant warned, *"You can do things badly quickly and at scale with AI and create tools of mass destruction."*

Some network participants cautioned against allowing such concerns to unnecessarily impede innovation. An executive said, *"Before you get worked up about terrible things that can happen and the risks, establish the use cases and how they can be beneficial."* Another suggested that *"feeding objective rather than subjective data into the model"* can help control for bias. Overall, a director observed, *"Boards are getting more used to it. Every project moves it forward a bit more."*

Appendix

The following individuals participated in these discussions:

Participants

- Homaira Akbari, Non-Executive Director, Santander
- Michael Alix, Americas Chief Risk Officer, UBS
- Jeff Barbieri, Vice President, Corporate Governance/ESG Research, Wellington Management
- Drew Barker, Senior Vice President, Head of Climate Risk Management, Truist Financial
- Richard Berner, Clinical Professor of Management Practice, Department of Finance and Co-Director, Volatility and Risk Institute, NYU Stern School of Business
- Sarah Beshar, Non-Executive Director, Invesco
- Howard Boville, Head of IBM Cloud Platform, IBM
- Jan Carendi, Non-Executive Director, Lombard International Assurance
- Bill Coen, Non-Executive Director, China Construction Bank
- James Cole, Non-Executive Director, AIG
- Kristen Dickey, Non-Executive Director, Somerset Re
- Dianne Dobbeck, Head of Supervision, Federal Reserve Bank of New York
- Beth Dugan, Deputy Comptroller for Large Bank Supervision, Office of the Comptroller of the Currency
- Eliza Eubank, Managing Director and Global Head, Environmental and Social Risk Management, Citibank
- John Fitzpatrick, Non-Executive Director, AIG
- Emily Gaston, Analyst, SASB Standards Financials Sector, Value Reporting Foundation
- Mike Gibson, Director of the Division of Banking Supervision and Regulation, Federal Reserve Board
- Jay Grayson, Chief Executive Officer and Co-founder, Surround Insurance
- Carlos Gutierrez, Non-Executive Director, MetLife; Chair and Chief Executive Officer, Empath
- Carlos M. Gutierrez, Chief Marketing Officer, Empath
- Bob Herz, Audit Committee Chair, Morgan Stanley and Fannie Mae
- Brad Hu, Executive Vice President and Chief Risk Officer, State Street
- Tim Keaney, Audit Committee Chair, Unum
- Sandra Krieger, Non-Executive Director, Deutsche Bank USA

- Joan Lamm-Tennant, Chair, Equitable Holdings and AllianceBernstein; Non-Executive Director, Hamilton Insurance Group
- Christine Larsen, Non-Executive Director, CIBC
- Marc Lindsay, Managing Partner and Director of Research, Sustainable Governance Partners (SGP)
- Nick Lyall, Non-Executive Director, USAA Savings Bank
- Michel Madelain, Non-Executive Director, China Construction Bank
- Callum McCarthy, Nomination and Compensation Committee Chair, China Construction Bank
- Tracy McKibben, Audit Committee Chair, USAA
- Dambisa Moyo, Co-Principal, Versaca Investments, Global Economist, Author, and Board Member
- Diane Nordin, Audit Committee Chair, Principal Financial; Compensation and Human Capital Committee Chair, Fannie Mae
- Gordon Orr, Non-Executive Director, Lenovo, Meituan, Swire Pacific
- Andy Ozment, Chief Technology Risk Officer and Executive Vice President, Capital One
- Marty Pfinsgraff, Risk Committee Chair, PNC Financial
- Chris Pinney, President and Chief Executive Officer, High Meadows Institute
- Bruce Richards, Vice Chair, Credit Suisse Holdings USA
- David Sidwell, Non-Executive Director, Chubb
- Nick Silitch, Senior Vice President and Chief Risk Officer, Prudential Financial
- Bob Stein, Audit Committee Chair, Assurant and Talcott Resolution

EY

- Jan Bellens, Global Banking and Capital Markets Leader
- Peter Davis, Americas Financial Services Markets and Solutions Leader
- Matt Handford, Principal, Climate Change and Sustainability
- Ed Majkowski, Americas Insurance Sector and Consulting Leader
- Isabelle Santenac, Global Insurance Leader
- Sophia Yen, Principal, Insurance Strategy and Innovation Leader, Financial Services

Tapestry Networks

- Dennis Andrade, Partner
- Eric Baldwin, Principal
- Tucker Nielsen, Principal
- Andre Senecal, Associate

About this document

About *ViewPoints*

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

About the 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.

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Endnotes

[1] *ViewPoints* reflects the network's use of a modified version of the Chatham House Rule whereby names of summit participants and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Italicized quotations reflect comments made by summit participants and guests.

[2] Barbara DeLollis, "Banks, Late to the Game, Double Down on the Cloud," *CIO Dive*, February 14, 2022.

[3] Jared Council, "Banks See Pressure in AI Race from Fintechs and Big Tech," *Wall Street Journal,* August 21, 2020.

[4] Bank Governance Leadership Network, "Expanding artificial intelligence and machine learning applications in banking," *ViewPoints,* June 2021, 4.