INSIGHT

Financial Services

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The Evolving Agenda of the Banking CFO: Driving the Transformation

The role of the chief financial officer (CFO) in a large global bank has changed dramatically, bringing with it increased opportunities to excel—but also many and various challenges. Now seen as a key and trusted partner of the CEO, the CFO has an essential role to play in the transformation of a business, with a lengthening list of critical tasks, extensive responsibilities, and major objectives.

The global financial system has undergone profound change since the crisis of 2008, driven largely by increased economic and geopolitical volatility, and reregulation. And the relatively static competitive landscape has been shaken up by a range of issues:

- large remaining stocks of nonperforming loans and noncore assets not only in Europe but also, increasingly, in China and India;
- progressively unsustainable cost structures;
- enhanced regulatory and compliance standards; and, finally,
- the digital revolution.

As a result, a wave of financial technology (fintech) companies and shadow banks has arisen to challenge the incumbents' business models.

Finding solutions to all of those challenges and identifying what comes next for the financial services industry have therefore become more and more important to the boards and CEOs of the main banks, and as a consequence, those main banks' CFOs are taking higher-profile roles in addressing such critical issues. CFOs are helping figure out how to balance the trade-offs between effective restructuring and a return to growth and between digitalization and regulatory best practice.

The imperial CFO: Augustus or Nero?

It was The Economist that recently identified this elevated role as the "imperial CFO", noting that CFOs are now at the heart of most of the world's big companies and are accumulating power, which may or may not be a cause for concern.[1] For example, The Economist observed that CFOs:

- are deeply involved in the corporate strategy setting, acting as CEOs' copilots.
- allocate capital and other scarce resources to bring strategies to life.
- play growing roles in overseeing corporate operations and cost-cutting programs.
- talk to investors, board directors, and regulators, among others.

But who is the role model? And can the term imperial ever be a good thing when applied to a corporate officer? The Economist concludes that it cannot. Certainly, as the articles states, the days of the Imperial CEO are long gone. Think of Julius Caesar as the prototype, and remember how his tenure ended. As for an imperial CFO, it may depend on whether the emperor in question more resembles Augustus by successfully leading the company through new cycles of growth or more resembles Nero, ready to set the Eternal City ablaze for glory and revenge.

[1] Schumpeter, "The imperial CFO: Chief finance officers are amassing a worrying amount of power," The Economist, June 18, 2016.

However we tag it, the role of the CFO at a global, diversified bank has certainly changed significantly in the past 20 years—much more so than for the corporate counterpart. And that change has accelerated in the past six, following the Lehman Brothers bankruptcy. Now the role is even more relevant, critical, and powerful: some might say almost impossible to bear. Let's look at how it has evolved.

Bean-counting controller

The position of bank CFO began with backward-looking controlling, and reporting functions. The forward-looking functions of planning and commercial and capital budgeting were added progressively, but the role remained focused on the bank's internal workings and interplays, separate from the outside market and other stakeholders.

Strategic architect

The role then acquired a more-outward-looking dimension: to define a proper competitive strategy, the CFO had to acquire a thorough understanding of markets and competitors, had to then become more of an architect of the future business model, and had to therefore learn how to communicate better with third parties.

Captain of capital

The next responsibility came when the controller—invariably competing with the head of finance for the CFO title—also began to look after the capital and funding structure. The role grew to encompass capital manager and first port of call for equity and debt institutional investors.

Warden of risks

Then, new regulatory requirements, starting with Basel II, elevated the CFO's position higher still. The CFO now needed a thorough understanding of finance, risk management products, and trading strategies, which sometimes led to direct competition with the chief risk officer.

Value director

Finally, having clarified the risk management perspectives, the CFO became the ultimate director of the internal, value-based, competitive marketplace, allocating the most-critical roles and resources across the group—both tangible and intangible, not just economic capital.

How to fight the barbarians at the gate

Recently, the CFO role has expanded yet again as a result of the financial crisis, recent reregulation, and the digital revolution. The four areas of evolution we see are:

Deal maker

As a consequence of the nonperforming, noncore financial, credit, and operating assets hangover still looming in many developed countries, the CFO has taken the main role in leading the deleveraging and derisking of banks' balance sheets. Specifically, the CFO is taking the lead in bad bank setup and in credit workout unit carve-out and development—often jointly with third parties and with a view to reach deconsolidation.

FIGURE 1: Evolution of the banking CFO

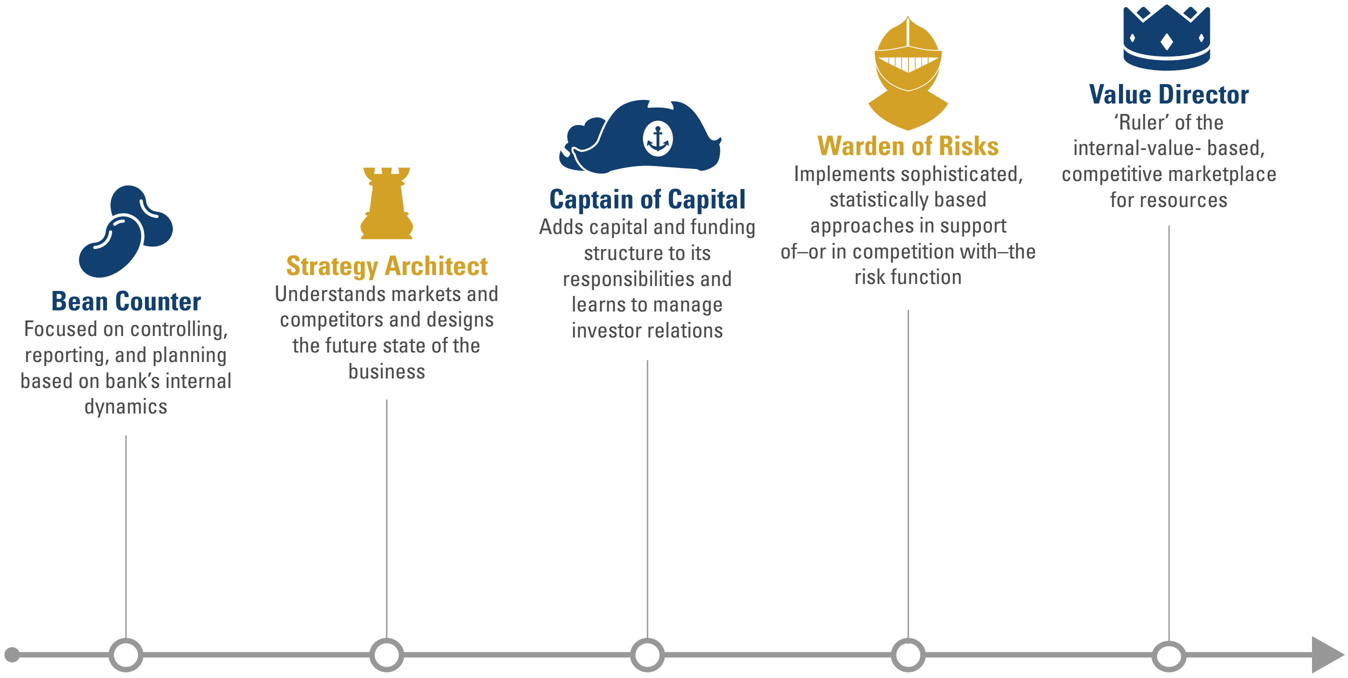
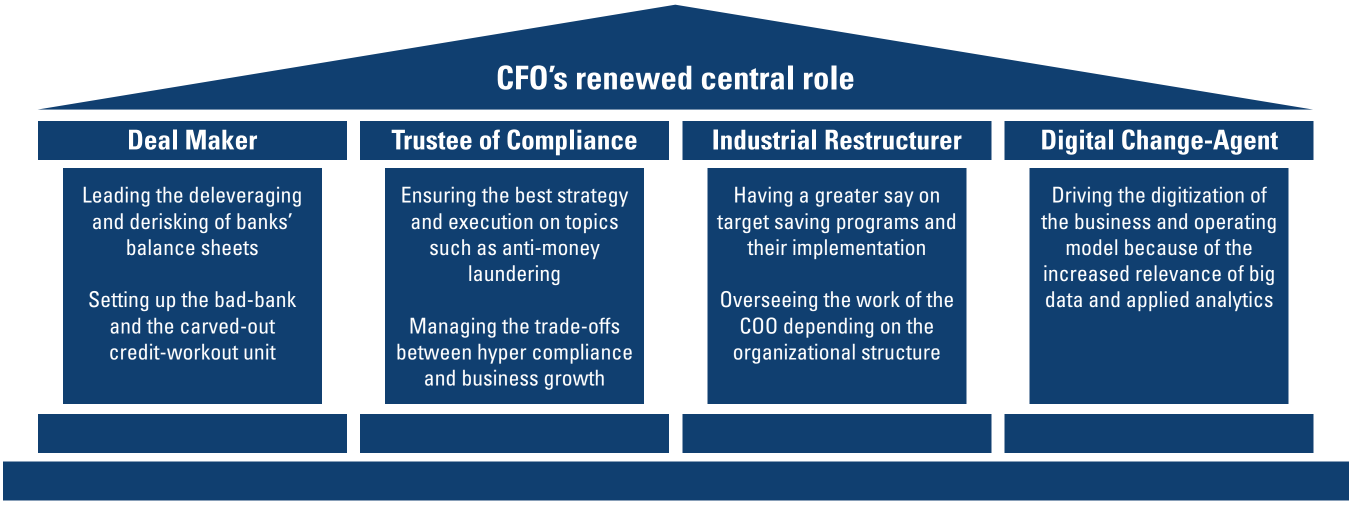


FIGURE 2: Four new critical pillars



In a near zero/negative interest rate market environment, the CFO is increasingly called to find new ways to structure the available capital and excess liquidity of the bank. It is necessary to find yield enhancing opportunities to sustain the traditional net interest margin core revenues, taking into account a range of implications at the level of the regulatory capital (sometimes defined differently by different jurisdictions and with different local "finishes").

Trustee of compliance

Following the wave of fines and sanctions imposed on global banks, and given the increasingly complex and costly efforts required to satisfy new compliance requests, the CFO now plays a role in ensuring the best strategy and most efficient execution in such areas as anti–money laundering. The CFO also manages multiple trade-offs between the hypercompliance–zero tolerance pursued by the chief of legal, as well as numerous constraints on capital and businesses. And if the bank appoints a chief conduct risk officer to monitor and manage bank employees' behaviors and report directly to the CEO, then the CFO could even end up aggregating the compliance functions.

Industrial restructurer

The increasingly cumbersome cost structure of a bank's current operating model and the instances when chief operating officers (COOs) fail to deliver effective operational efficiency programs have led to the CFO's having greater say on target saving programs and their implementation. In some instances, the CFO and COO roles have been united or realigned so that the COO reports to the CFO.

Digital change-agent

Finally, the CFO is helping drive digitization of banks' business and operating models and helping develop the "capitalization" of data. This follows the rise of big data, the use of applied analytics to turn big data into business opportunities, and the increasing number of competitive challenges posed by fintech nonbank players—not to mention the significant capital required to invest in digitizing a bank. The CFO should also have a good understanding of the increasingly crucial cybersecurity risk, which is not only an IT technical issue, but also a strategic issue with relevance to business continuity, capital absorption and even the viability of the competitive strategy of the bank itself. The situation requires that the chief data officer report to the CFO, as some already do.

There is a common theme across those four aspects, which capitalizes on the CFO's historical roles, outlined earlier. The theme is the CFO's role in driving the transformation of a bank—a transformation that is complex and potentially destabilizing for systemic banks. It's a once-in-a-lifetime transformation, brought on by a range of challenges: the hangover of the past global crisis, reinforced by recurring geopolitical turbulences; the unsustainable cost structures of the brick-and-mortar business model; the new wave of compliance rules; and, finally, the digital revolution. It is that last challenge that is allowing new, digital, nonbank players—the barbarians at the gate—to disrupt all of the fundamental functions of the global financial system.

Driving the transformation

The CFOs of globally diversified systemic banks now have an important mission. They can help the empire survive and prosper again: they can deal with the new fintech barbarians by integrating them—rather than resisting them—while still meeting outstanding challenges.

But there will be turbulent years ahead as they face all of the challenges simultaneously while still managing their fundamental roles and responsibilities. The bank CFO will require multiple skills and support from many parties to drive that transformation agenda. The skill needs are:

Financial and industrial skills and support for deleveraging and derisking, with a key challenge coming from the development of alpha-platform credit workout units and bad banks.

- The successful CFO will drive the bad-bank transformation because the value to be lost or recovered is immense. This outcome could either lead to a systemic crisis and the collapse of some of the systemically important financial institutions or become a source of reward—and even of new businesses that would be able to exploit the opportunities the situation offers.

Restructuring and turnaround skills and support for the significant cost take-out required of the operating model, with a key challenge linked to its industrialization to maximize efficiency.

- The successful CFO will drive the cost transformation because it is a critical component the bank must manage in order to survive and to recover profitability. The CFO will be a partner and the counterpart of the COO, negotiating and challenging the COO, as well as taking a more-leading role in both setting targets and delivering on them.

Regulatory and compliance skills and support for the automation and execution of the most-effective regulatory and compliance strategies, with a key challenge that lies in optimizing their trade-offs.

- The successful CFO will drive the compliance transformation as it feeds into the capital requirements and the business performance, with the amount of fines and potential liabilities becoming key determinants for the bank. Topics such as checks on anti–money laundering; knowing your customer; misselling to clients; and related remediation plans will become crucial parts of the successful CFO's agenda.

Information technology (IT) change and innovation skills and support for the digitization of the company, likely involving a full transformation, front to back, of the business machine while keeping it running at full speed

- The successful CFO will then be involved in the overall IT and business transformation to digitize the bank and leverage its data, which is the main intangible capital-driving value. The successful CFO will also manage the bank's goodwill and brand equity, which will become threatened by fintech challengers if badly managed.

Memoirs of a CFO

Finally, let's look at this from the perspective of another emperor who provides a different role model. Hadrian was one of the greatest emperors of the Roman Empire, and as Marguerite Yourcenar reminds us in one of her novels, his administration was initially a time of peace and happiness.[2] But later in his life, events caused him to ponder his unraveling plans for peace and to dread the rampant destruction that preceded the fall of the Roman Empire.

In the last part of his memoirs, a then aged and tired Hadrian contemplated the empire's changing fortunes and destiny: "Natura deficit, fortuna mutator, deus monia cernit" ("Nature fails us, fortune changes, a god beholds all things from on high").

It's a useful reminder that no CFO is infallible: whatever strengths lie within, the CFO may face trouble and require support from on high to safeguard the bank. Whatever the challenges, a little humility and a sense of history will help every CFO—imperial or merely mortal.

FIGURE 3: Identikit (and challenges) of the bank's CFO of the future

CFO's Reading List

Financial and industrial skills	How to drive the bad-bank transformation, because the value to be lost or recovered in the transformation is immense
Restructuring and turnaround skills	How to drive the cost transformation as a critical component in order to successfully survive and recover profitability
Regulatory and compliance skills	How to drive the compliance transformation so as to optimize capital absorption and foster growth despite ever-more-stringent regulatory constraints
IT change and innovation skills	How to contribute to the overall IT and business transformations for the banks digitization and how to leverage data as the main intangible capital

[2] Marguerite Yourcenar, Memoirs of Hadrian, 1951.

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