

The lost City

Antony Jenkins believes the rise of new data-driven technologies in financial services will likely mean the end of traditional banking roles and the demise of the City of London

The City of London's function has not much changed for centuries. From the seventeenth century coffee shops in and around Lombard Street to the twenty-first-century trading floors of Canary Wharf, financial services have intermediated funding by linking those who need money with people or organisations who have it. In times gone by, this was based on face-to-face relationships. But, as the economy grew and commerce became more complex, a process was required to manage deals and transactions, settle payments and keep track of people's money over large distances. Intermediation developed to meet this need, initially with paper-based contracts and records but becoming increasingly automated as computing power evolved. The rise of new data-driven technologies now threatens the complete transformation of this system. To understand why, we need to consider another important function of the City: the management of risk.

Today, retail banks underwrite loans and personal credit, and investment banks underwrite securities, such as stocks and securitised mortgages. As intermediaries, pairing organisations and consumers, banks manage the risks associated with these products. To reduce that risk, they are required to raise significant amounts of equity capital to fund their businesses. This buffer of capital is expensive. Complying with regulations is also costly, complex and often time-consuming. The result is an inefficient and expensive system that poorly serves customers, can generate huge, rent-seeking profits for the intermediaries and yet can still fail in a downturn. But change is coming.

Financial products – loans, mortgages, bank accounts – are just data. Because computing power has increased exponentially while getting ever cheaper, we now have the portable supercomputers – smartphones – and cloud computing that allow us to manage data much more effectively. That has led to the first wave of fintech transformation: app-only banks, peer-to-peer lending, digital payments and online foreign exchange. We are now seeing the rise of new, leading-edge technologies, such as machine learning and distributed ledgers, that promise further transformation. Distributed ledgers underpinning cryptocurrencies such as bitcoin offer a tamper-proof digital record of every transaction that takes place on a digital network. Yet the rules governing that system are not controlled by intermediaries, such as a bank. Instead, they are controlled by all of the participants in the network itself, creating a self-policing system with no need for central oversight.

Such a system is not without practical challenges – not least the significant amount of computing power that a digital

ledger requires – but its underlying potential to circumvent the intermediaries of the financial services industry is enormous. You could use it to pair borrowers directly with investors, without a middleman keeping track of the loan and making a profit. Pension funds could offer mortgages directly to borrowers, companies could offer shares directly to investors, and instant global peer-to-peer payments could become a reality, eliminating a swathe of expensive currency exchanges. No opaque middlemen calling the shots means a more transparent, cheaper and quicker way to manage data.

“*Today's gleaming financial towers will stand as legacy monuments in the long term*”

The real question, then, is to what extent technology will automate the process of intermediation. If it is a great deal, as looks distinctly possible, then why would you need banks? If you do not, how will that transformation occur? In the medium term, there is no doubt that thousands of financial services jobs will disappear, replaced by digitised services. I predicted three years ago that new technologies such as app-based banking would lead to job losses and bank branch closures. Those predictions are now coming true, faster than even I thought. Over the long term, change will be even more dramatic. If the management of funding, risk and data can be done entirely over decentralised ledgers, at lower cost and with greater transparency, then there is no need for the City as a physical entity to exist. Like the cotton mills of Lancashire in the 1960s, today's gleaming financial towers will stand as legacy monuments to a system that has been eclipsed by a new economic model.

That will be of enormous benefit for customers, who will enjoy lower costs and more accessible financial products. In turn, that will spur economic growth, to the benefit of society as a whole – but not so much for the banks of today and the denizens of the City and Canary Wharf. ■



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