CFA SINGAPORE INSIGHTS

By Pranay Gupta

Fintech is growing, and continues to evolve

The industry has expanded since 2010 with global investments increasing 800% to a peak of US$26b in 2015

COMPANIES and their management teams fall into four categories of progressive phases, when faced with a disruptive change.

The Naysayers: who deny any meaningful impact from a new technology or process; and worse still, gather facts to disprove its usefulness. This is why startups are difficult, and why new technologies tend to be disruptive rather than augmentative.

The Charlatans: who publicly say that their firm is using new technologies and techniques, because it seems like a good marketing pitch, but in reality are doing very little internally to actually incorporate its usefulness. This stage is present when a new technology has developed sufficiently to be noticeable, but is still below critical mass or unproven.

The Early Adopters: who have come to believe that utilising the new technology is in their interest, have a business plan and have created internal teams to take advantage of the new paradigm to augment their existing business model.

The Believers: If not the startups themselves, these are the firms that are convinced of the philosophy of a new technology and are prepared to reorient their companies for the future along with the implementation of a new structure.

Fintech is going through this evolution as we speak, and the different categories of fintech innovations are at different stages in this evolution. In our new book, *Fintech: The New DNA of Financial Services*, to be launched at the 2018 Singapore Fintech Festival, we explore each of these categories, their state of play and their progression and impact on the financial industry.

The state of fintech in the banking industry

Pauline Wray and Simin Liu of BCG/Expand Fintech Control Tower, who detail the chapter on "The State of Fintech" in our book write that the fintech industry has witnessed an unprecedented growth since 2010 with global investments increasing 800 per cent to a peak of US$26 billion in 2015. In the mid-90s, Bill Gates had made a bold statement claiming that while "banking is necessary, banks are not". Fintech is fulfilling that promise.

Technology giants have started encroaching into various financial services verticals. Amazon was said to be in talks with JPMorgan to offer current accounts; FaceBook-owned social messaging platform, Whatsapp, has already beta-launched WhatsApp payments in India in March 2018 (though full deployment has been delayed by FaceBook's recent data leakage scandal); Ant Financial, the subsidiary of eCommerce giant Alibaba, is now one of the largest bank in the world in terms of valuation after raising their record US$10 billion Series C funding in 2018. In a different industry, Grab, the ride sharing platform announced in March 2018 the launch of Grab financial which will focus on offering loans and insurance to the underbanked population in South-east Asia . . . the list can go on. With the move towards Open Banking, anyone can now offer banking services, be it telcos, transport, car or technology companies.

Banks have felt the heat as they increasingly fall behind competition in the ability to capture critical customer data points. Singapore banks and some of the larger global banks have become early adopters of fintech technologies, and while they are still taking baby steps towards a fintech banking future, they have left the category of naysayers and are progressively adopting a fintech based business model. Some inevitably continue to deny the processing benefits of fintech in their middle and back offices, and will eventually get disrupted.

Fintech and the investment management industry

The investment management industry on the other hand has yet to grasp and deal with the dramatic changes that could happen with the proliferation of fintech, and most asset managers today are still naysayers or charlatans.

Investment managers derive the majority of their revenue from selling single asset class active management products to institutions and individuals. With the advent of fintech, there are four fundamental changes which few asset managers are preparing for.

1. Distribution: Investment management has traditionally relied on an army of intermediaries such as fund salespeople and financial planners who while not investment savvy, attempt to cultivate "relationship-based sales". The ease of distribution methods by platforms such as robo-advisers will disrupt this paradigm. If a company has a dozen relationship type salespeople today with limited investment knowledge, in the future they should consider having have half as many who have the investment knowledge to be client investment solution providers, rather than relationship sales.

2. Investment process: Traditional active portfolio managers rely on their judgement for investment decisions. That skill will remain undisputed. However, given the sheer enormity of data that is now becoming available, it will be practically impossible for any fundamental manager to claim skill, if he is not able to utilise the knowledge from this "big data". Every fundamental investment process in the future will require a robust data and quantitative analysis based decision support toolkit for the investment process to retain skill. If an asset manager has 45 fundamental portfolio managers and analysts and five quants, that ratio will need to evolve to 25 each of fundamental and quant investment professionals in the future. Most importantly, they need a chief information officer (CIO) who knows and understands quant, as CIOs rarely take investment decisions, but they do manage the teams and govern the structure.

3. Risk management: Analysing and managing portfolio risk has always been considered as a subservient, post investment decision activity which happens weekly or monthly, and risk managers are poorly compensated compared to portfolio managers. Nothing could be further from the truth. Availability of big data can help manage portfolio risk real time, concurrent with an investment decision. If an asset management firm still has risk management staff sitting in the middle office, they should consider integrating them with the front office, equipping them with the data and tools to analyse risk real time, and giving them the investment responsibility of "how not to loose money", just the portfolio managers are entrusted with "how to make money".

4. A Multi-asset world: Over 90 per cent of the fees, time and resources of any investment manager is spent on single asset class relative return products. This is at odds with the "real" investment problem of any endowment, insurance, sovereign fund, pension or individual, which is a multi-asset total return problem. Ask yourself which of your asset managers will be accountable if the markets fall 20 per cent tomorrow and you lose roughly that amount of money, and the answer is generally none of them – because they all manage relative return. Managing the fall requires multi-asset allocation skill, which accounts for over 80 per cent of the risk of any client portfolio, not single asset class security selection skill. To solve the real client investment problem, instead of having 90 security selectors and 10 allocation specialists in your investment team, investment managers should consider having 50 allocators and 50 security selectors. Allocation methods can be just as disparate and different as security selection processes, and are much more important and relevant to a client.

Developing fintech processes requires knowledge of programming and advanced econometrics, apart from finance, and 95 per cent of the current management and staff in banks and investment managers lack these skills. But understanding fintech should not require a prerequisite of knowing programming and econometrics. Our book is written precisely with this structure and objective. The 95 per cent must understand fintech processes and adapt to them, even if they cannot code.

Pranay Gupta CFA is the co-author of the forthcoming book, *Fintech: The New DNA of Financial Services*, to be launched at the Singapore Fintech Festival in November 2018