FINTECH: Financial Technology and how it might Impact the Financial Services Industry

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I recently came into possession of a copy of a speech made in 1984 by LIA Past President Brian Toolan, in which he speculated upon future technology developments in financial services. To quote Brian directly:

"I see tremendous possibilities in the area of computerisation in the life insurance industry and not just in terms of Broker Management and Word Processing. In particular I would like to see the introduction of what I would term Quotation Software which would facilitate instant retrieval of competitive quotations from major insurance companies simultaneously. Considerable scope also exists for the development of software which would enable an adviser to keep track on a daily basis of the value of his clients' insurance-based investments, particularly in the Unit Linked area."

I think it fair to say that in the intervening years the industry has evolved technologically to meet and exceed Brian's expectations. So the use of financial technology, or fintech as it is now described, is not a recent development. However, it does again merit close consideration in light of the expected impact of impending technology developments on the global financial services industry. To get some sense of the importance of fintech, between 9th January and 24th February there have been 32 articles published in the Financial Times alone on this topic.

What is fintech?

Fintech describes a broad spectrum of financial technology that will improve the efficiency and effectiveness of process-driven tasks across the spectrum of financial services. It will impact on all levels of the financial services industry including administration, underwriting, management, compliance, risk management, accounting, asset management etc. It is expected that the adoption of these technologies will have a disruptive effect on all aspects of our industry.

Furthermore it will enable new entrants to join the financial services industry, who will not need to burden themselves with expensive branch networks or back-office functions. For example, when the chairman of one of the world's biggest banks was asked recently how technology would change finance, he pointed to the rise of Ant Financial, the digital payments arm of Alibaba, China's ecommerce colossus. Ant Financial gained about 100m new clients last year (2016), taking its total above 500m, almost 10 times the level of the world's biggest banks. As another example, last October the Central Bank of Ireland added an unexpected company to its roster of digital payment providers – Facebook Payments International Limited. The licence it granted authorised Facebook to provide basic financial services, such as electronic money transfers, to all citizens of the EU.

At a recent event I attended in Amsterdam, it was speculated that it may not be too long before the biggest financial institutions in the world are Facebook, Amazon and Google. Think of the motor industry and how that has evolved so that most car manufacturers now also operate a financial services arm.

New EU regulations on customer data

Banking in Europe is also expected to be transformed by new EU regulations – the Revised Payment Service Directive (PSD2) which will take effect in 2018. The directive is designed to boost competition in the name of 'open banking', by forcing banks to allow third parties to access the data of customers who authorise it. The likely effect is two-fold: on the one hand it will make it easier for banks to poach their rivals' clients, rivals will include insurance companies, independent advisers etc.; and secondly the regulatory change could also unleash competition for banks from fintech start-ups and big Silicon Valley technology groups such as Facebook, Amazon and Google.

Robo-advice

One of the most talked-about areas of fintech is 'robo-advice'. It has been described as the fatal disruptor of traditional wealth management. It is the area of fintech that I will concentrate on for this article. Robo-advisers – websites that recommend a portfolio of funds based on an investor's answers to an online questionnaire – disrupt traditional face-to-face advice by offering a low-cost alternative to customers who are increasingly comfortable with digital investing. Citigroup estimates that assets managed by robo-advisers could reach $5tn globally during the next decade. International and domestic banks, asset managers and wealth managers have also spotted the potential of robo-advice, as the technology is cheap and enables fund companies to retake business from independent advisers. Robo-advisers are already established internationally, and it is expected that over the next 12-18 months we will see a similar presence here in Ireland.

Of concern to consumer advocacy groups internationally is that in most cases, based on answers to a string of financial questions, robo-advisers come up with several potential courses of action. The consumer then makes the final decision and thus the robo-adviser cannot be sued for providing poor advice. I think it fair to suggest that most consumers will not understand the distinction between being given 'financial advice' and 'financial information'.

Some examples of robo-advisers:

- China-based Tianhong Asset Management has attracted 300 million users to Yu'e Bao, its online money market fund, in just over three years.
- Deutsche Asset Management, owner of ETF business DB X-trackers, is working on its own automated-advice solution, which is due to launch later this month (March 2017).
- Allianz has bought a stake in the robo-adviser MoneyFarm.
- UK banks Barclays, Royal Bank of Scotland, Lloyds Banking Group and Santander UK have said they are developing online investment websites, as has Swiss bank UBS, Hong Kong bank HSBC and wealth managers Investec Wealth and Brewin Dolphin.
- Source, a European ETF provider with €21bn in assets under management, has identified robo-advice as a growing distribution channel for its ETF products.
- BlackRock, the world's largest fund house, has bought robo-adviser FutureAdvisor.
- DeGiro, a Dutch-based ETF and share trading platform, has an online presence in Ireland with 7,000 Irish clients. It is regulated by the Dutch Central Bank.

Some perspective - will robo-advice appeal to consumers?

Unsurprisingly, the evidence so far is that the appeal of robo-advice is likely to differ depending on the age of the consumer. Millennials, those born between 1980 and 2000, are the first generation who have grown up with the internet and are likely to prefer cheaper online services to traditional wealth managers. According to 2016 UK research (Legg Mason) 85% of UK-based millennials are comfortable with robo-advice compared with 37% of investors aged 40-75. However, it is estimated that 98.5% of global assets under management ($71tr) are held by the older age-group (Pitchbook). CSO statistics confirm that wealth distribution in Ireland is also heavily weighted towards the older age groups. A study conducted last year by LinkedIn, the social network for professionals, found that many regarded a social media presence as a 'must have' for a financial services provider.

These unrelated pieces of research suggest that financial advisory firms of the future will need to: 1) have an online presence; and 2) develop business models that include different customer propositions and delivery options; and that take account, at the individual client level, of service and access requirements. It seems unlikely that a one-size-fits-all approach to the use of robo-advice will be successful.

Risks and the response of regulators

Risks identified with the development of robo-advice include possible flaws in the algorithms, the potential for mis-selling, the danger of data protection breaches, and concentration risk arising from 'herding' of investors into similar strategies and underlying index investments.

At the time of writing, I am unaware of any concrete measures taken by regulators in Ireland or elsewhere to deal with consumer protection and manage systemic risks posed by robo-advice. That being said, it is clearly on the regulatory agenda globally. In February 2017 IOSCO (*an association of organisations that regulate the world's securities and futures markets)* published its paper on financial technologies in which it recommended that "securities regulators adopt pro-active measures to keep pace with technological innovation". Mark Carney (Governor, Bank of England), who is chairman of the Financial Stability Board that makes recommendations to G20 nations, said recently that "fintech could signal an end to the traditional universal bank model" and that "it could also increase herding risks and make the system more interconnected and complex". The Basel-based FSB is already scrutinising what risks and rewards fintech might present, and what regulators should do about it. It will report to the G20 in July. On 23rd February of this year, the Governor of the Central Bank of Ireland acknowledged in a speech that "there are risks, as well as advantages, for consumers from the greater use of technology to deliver financial products and services and from the pace and scale of technological innovation in the financial services industry". And in March 2017, the EU commission published a paper 'FinTech: A more competitive and innovative European financial sector' to which they have invited comments from stakeholder groups.

In a paper published in 2016 the Financial Planning Standards Board highlighted its concerns on the unconstrained growth in robo-advice and suggested that regulators focus on:

- Preventing false or misleading claims by automated advice tools;
- Protecting consumers' interests by ensuring products recommended by automated advice tools are suitable;
- Protecting consumers (and the market) from cybersecurity threats;
- Ensuring adequate disclosure and explanation by fintech providers on the methodology they use, and the universe of products available to the automated advice tool;
- Preventing the concentration of risk, if too many consumers in a given market are in the same portfolio allocation; and
- Ensuring that regulations and legislation stay relevant in a rapidly changing technological environment.

It strikes me that our minimum competency and consumer protection codes need revising in light of this rapid adoption of technology-driven advice, and that investment is required to improve the financial literacy of consumers.

What does the future hold for financial planning businesses?

It seems likely that fintech and robo-advice in particular will accelerate the commoditisation of financial products. It also seems likely that the speed of adoption of robo-advice by consumers will vary depending on age. As I have suggested in previous articles and presentations it will become even more important for financial planning firms to develop new customer propositions that clearly demonstrate the value-added advice that they bring to the table.

Robo-advisers have the sole aim of selling the company's investment portfolio services. Yet putting cash into an investment portfolio is not always the right answer: debt reduction, building an emergency fund, saving for retirement, purchasing risk products or investing in a business may be more appropriate. The most important financial task many people need doing for them is 'lifestyle financial planning'. This is not something well-suited to a digital service. It entails identifying and articulating certain aspects of the kind of life the client wants, taking into account their attitude to money, psychological biases and personal circumstances. It also involves the quantitative aspect of how to make money last a lifetime under various 'what if' scenarios, using financial planning software and sensible underlying assumptions. Doing it well requires a good deal of personal information, effective financial scenario modelling and a tax strategy. Although technology can streamline elements of this service, the emotional, coaching and collaborative aspects, together with the complexity of the tax, retirement and welfare systems, mean it does need the input of a human adviser.

Recognising this, Betterment, a New York-based robo-adviser with about $7.3bn under management, recently hired a team of financial advisers so that customers will be given the option of a consultation with a financial adviser once a year. This move vindicates the view of analysts who have long argued that it was inevitable that the newcomers would start to resemble traditional brokerages, with teams of advisers selling higher-margin services.

In all probability therefore, the future of financial planning will be a combination of services based on automation and a more traditional, in-person advisory service.

Taking a leaf from Brian's presentation in 1984, I will close by setting out my thoughts as to what a financial planning business of the future might look like:

- Customers will be given free access to impartial financial education and basic financial data tools that help them track their spending, net worth and debts;
- Junior qualified staff will help potential customers assess the type of financial service that they need and would get value from, as well as helping the customer gather their basic financial data via an online portal (assuming PSD2 goes ahead);
- Senior qualified staff will carry out collaborative advice and planning consultations with customers via video conferencing software, thus enabling advisers to be located in lower cost areas of the country rather than expensive city centre offices;
- The customer will pay a flat annual planning fee (retainer) based on the level of complexity entailed and the service desired. This will remove potential conflicts of interest and ensure objectivity and independence;
- Any financial products and services required as part of the agreed plan will be charged to the client as an implementation cost, and will be charged at different price points. Those clients availing of the cheapest client proposition will likely be charged a modest additional implementation fee. Those clients availing of a more expensive financial planning proposition will likely not face any additional costs.

As I have suggested in previous articles and presentations, it will become even more important for financial planning firms to develop new customer propositions that clearly demonstrate the value-added advice that they bring to the table.