Digital Finance Platforms in Asset Management – Towards a new regulatory paradigm

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If we think about “FinTechs”

We typically think of small agile start-ups

The term doesn’t usually encompass Goldman Sachs, or Blackrock (Aladdin) or Ant Financial. But all three lead the world in applying technology to delivering financial solutions.

The world’s focus has been on these small agile start-ups. And they matter. But they are far from the main game.

Today, which companies, in the main, win, and win big?
Big winners of past 5 years -- tech and platform companies

- 2001:
  - #1: GE, $406B
  - #2: Microsoft, $365B
  - #3: Exxon, $272B
  - #4: Citi, $261B
  - #5: Walmart, $260B

- 2006:
  - #1: Exxon, $446B
  - #2: GE, $383B
  - #3: Total, $327B
  - #4: Microsoft, $293B
  - #5: Citigroup, $273B

- 2011:
  - #1: Exxon, $406B
  - #2: Apple, $376B
  - #3: PetroChina, $277B
  - #4: Shell, $237B
  - #5: ICBC, $228B

- 2016:
  - #1: Apple, $582B
  - #2: Alphabet, $556B
  - #3: Microsoft, $452B
  - #4: Amazon, $364B
  - #5: Facebook, $359B

- 2018:
  - #1: Apple, $927B
  - #2: Amazon, $778B
  - #3: Alphabet, $766B
  - #4: Microsoft, $751B
  - #5: Facebook, $542B
And what do the winners have in common?

What do Apple, Amazon, Google, Microsoft and Facebook have in common that GE, Exxon, Citi and Walmart did not, and do not?

Are GE jet engines exceptional? Are Walmart's prices to US consumers extraordinary?

But is an airline better off if more other airlines use GE engines?

Are American consumers better off if more other people shop at Walmart?

Is Microsoft the best software? Is Facebook the best social media platform? Is Uber even a decent company?

No, no and no!

So why do we use Microsoft and Facebook and Uber?
Network effects

Businesses with strong network effects tend to win, and win big.

What else has strong network effects?

Digital Financial Platforms in Asset Management!

**DFPs are operating systems that range from the front end to the back end – providing investment data and analytics through to dealing with settlement --**

So DFPs should grow and concentrate further. Most markets will in time probably only support one or two or at most three DFPs.

We’ve seen this in the US with Aladdin and in China with Ant Financial. The network effects are **massive** – because the data collected is harvested to improve predictive capacities.

Belonging to Aladdin provides access to better information than other investors have, legally!
Aladdin

Network effects are the key to the success of platforms. A platform links suppliers and consumers. It is the ultimate broker – clipping the ticket.

- A hotel without hotel rooms – AirBnB.
- A taxi company without cars – Uber.
- A retailer with little stock and few stores – Amazon.

DFPs are platforms that serve as Financial Operating Systems for banks, financial services companies and funds. Particularly funds!

Just as your laptop has an operating system with which you don’t interact much – you use the Apps that run on the OS – the OS is architecture – so is Aladdin the architecture of the funds management industry

“Aladdin is like oxygen. Without it we wouldn’t be able to function.” – Anthony Malloy, CEO, New York Life Investors

Aladdin is used to manage 10% of the world’s $50 trillion of investment assets.
Ant Financial

Valued at $200 billion – triple Goldmans. In 2018, it raised over a third of global VC funding ($14 billion). Alipay has 1.2 billion active users (with over 700 million in China). Ant’s funds have over 325 million investors. Ant has China’s largest fund brokerage platform.

So what is left for the banks? Answer in China today – “Not much”. Ant Financial is fast becoming THE financial operating system of the Chinese economy. Add in WeChat and Ten Cent and you have most of the Chinese financial system.
Are DFPs systemic?

Well “Aladdin is like oxygen”. Without it the US Funds industry “wouldn’t be able to function”. And US Funds control far more assets than US banks.

Sounds pretty systemic? Doesn’t it? TBTF and TCTF

If Aladdin stopped functioning many banks would experience severe operating issues and the Funds industry would largely grind to a halt at both front and back ends.

Ant has been designated as a non-bank SIFI in China since 2018.

The Americans are yet to work this out!

In the US, no DFP has been designated as a non-bank SIFI or a systemically important Financial Market Utility (which brings heightened prudential and risk supervision under Dodd-Frank).

The reason is the US regulatory triggers are balance sheet size, assets, counterparty exposures (ie. “follow the money!!”)
The focus has been on FinTechs

But DFPs are the Empire Striking Back! (with none of the boosterism that characterises the FinTech market)

DPPs are giant entities utilising all the data advantages of their size

This is a potent example of the massive challenges now facing financial regulators – regulators have had centuries to learn how to regulate banks – but our new world needs profoundly new approaches

Rather than ‘follow the money’ regulators now increasingly need to ‘follow the data and the data analytics’.

If you want to see the future of finance in Europe don’t look to America – where retail financial services are a mess with pain points aplenty -- look to China.

The rise of a pan-European DFP like Ant Financial or Aladdin is highly likely in time – and network effects will mean there will, in the end, be one or at most two which dominate.
Approaches to Regulation of DFPs

Asset managers assets are off their own balance sheets, and the risks they generate are mostly operational – and in that domain – massive!

As platforms, DFPs will tend to winner-take-all outcomes – see search engines, social media, retail, etc. This market dominance will likely limit general innovation severely – a real concern for contemporary regulators.

Financial regulation often tends to favour massive tech companies with the resources and capacity to respond to enhanced reporting and compliance obligations – so more traditional financial regulation is, ironically, likely to enhance the market dominance of DFPs.
Various regulatory approaches available

- Do Nothing (circa China up to 2015)
- Test and learn – sandboxes and hubs -- ??
- Require firms diversify, ie. use more than one DFP -- expensive
- Require firms rotate DFPs, as with auditors – expensive
- Declare certain DFPs systemically significant with heightened regulatory obligations and reporting requirements
- Such obligations could include mandating redundancy and resilience within the DFPs – regulators setting the standards and leaving their attainment to the DFPs?
Lead papers in our series …


