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ASSET MANAGEMENT **INSIGHTS**

INSIGHTS FROM THE BDO FINANCIAL SERVICES PRACTICE

5 FINTECH TRENDS TO WATCH IN ASSET MANAGEMENT

The COVID-19 crisis has shined a spotlight on asset management firms' digital transformation strategies. During the pandemic, contactless transactions and other financial services technologies that help prevent the spread of the virus have been embraced by customers, and organizations that already had a digital strategy in place were able to continue serving their clients seamlessly. However, most firms are still playing catch-up. According to BDO's ***2020 Financial Services Digital Transformation Survey***, just 19% of middle market asset management firms are currently implementing their strategy for digital transformation, and nearly half (44%) are either still in the process of developing that strategy (37%), or they plan to but haven't started yet (7%).

For asset managers, the unavoidable march towards digital transformation raises both opportunities and challenges, and this has only been accelerated by the current crisis. On the one hand, financial technology solutions are making operations more efficient and allowing asset management firms to expand and improve the services they offer to clients. On the other hand, an influx of fintech startups is disrupting the sector and threatening traditional investment flows. Here are five critical trends impacting the growth of digital solutions at asset management firms.

BDO'S ASSET MANAGEMENT PRACTICE

BDO's Asset Management practice provides assurance, tax and advisory services to asset management entities, comprising hedge, private equity and venture capital funds as well as regulated funds. The practice services over 600 advisors nationwide with funds ranging from start-up funds to those with billions of dollars under management.

TREND #1:

"EMERGING" TECHNOLOGY ENTERS THE MAINSTREAM

For the asset management industry, fintech applications are allowing firms to collect and leverage huge amounts of data that they can analyze to better inform decision making. Asset managers are also using these technologies to differentiate their service offerings as the environment becomes increasingly more complex and crowded.

BDO's *2020 Financial Services Digital Transformation Survey* found that many asset management executives say their organization is already deploying innovative digital capabilities, such as cloud computing (72%), advanced analytics (56%), Internet of Things integration (48%), artificial intelligence (44%) and blockchain (33%). We expect those numbers to grow in the future as the competitive landscape continues to heat up and consumers grow more comfortable and familiar with these technologies.

Among the top technologies disrupting the asset management industry:

INTERNET OF THINGS (IOT)

IoT connects "smart" devices to the Internet and to each other. With access to real-time data about clients' physical assets, asset managers are using this invaluable information to improve current products and services, capitalize on customer purchasing behavior and create more personalized user experiences.

ARTIFICIAL INTELLIGENCE (AI)

AI allows computer systems to simulate human intelligence when performing certain tasks and processes. Hedge fund companies, for example, are increasingly injecting AI into their stock trading operations and trading strategy. Operationally, the efficiencies represented by innovations like robo-advisors, chatbots, virtual assistants and other automated processes may portend a similar change in asset management.

CRYPTOCURRENCY

Cryptocurrency is a digital currency that uses encryption to secure and verify payments during transactions. According to the *2020 Financial Services Digital Transformation Survey*, 56% of middle market asset management executives view cryptocurrency as a competitive opportunity. The announcement last May that customers could now use Bitcoin as payment at Starbucks, Whole Foods and Nordstrom was an "I told you so" moment for cryptocurrency advocates, but even that shift into the Main Street mainstream was overshadowed a month later by the announcement that Facebook would launch its own digital currency, Libra. Look for the financial services industry, including fintech and Big Tech players, to develop and launch more crypto-related products in the future.

BLOCKCHAIN

Financial services and fintech businesses are leading the way in the development of blockchain, the distributed ledger technology used to make and record cryptocurrency transactions. In fact, Bank of America, home to the world's largest wealth management group by assets under management, is also the world's largest holder of blockchain patents. But blockchain technology's applications extend well beyond crypto. For asset management firms, blockchain's biggest benefits come from enabling improved data security and increasing the speed of data transmission—a critical element in keeping managers abreast of factors impacting their clients' portfolios and increasing operational efficiency.

TREND #2:

ASSET MANAGEMENT EMBRACES REGTECH

The use of technology to manage regulatory compliance is nothing new, but belt-tightening by the financial sector in the wake of the Great Recession bred an innovation explosion in the automation of labor-intensive tasks. Since then, the tenets and tools of digital transformation have fostered a fintech offshoot of regulatory technology, or regtech, companies.

For asset management firms, the emergence of regtech platforms is streamlining tasks like background checks, Anti-Money Laundering (AML) efforts and maintaining compliance with information security and privacy laws. This, in turn, is leading to lower costs and increased productivity. It's not surprising then that the *2020 Financial Services Digital Transformation Survey* reveals nearly half (48%) of asset management firms view this area of fintech as an opportunity to differentiate themselves from competitors.

Another development to watch is the emergence in the U.S. of regulatory sandboxes—government programs that provide a temporary waiver from normal regulations and licensing requirements. The concept, first introduced by the UK in 2015, allows companies to test new products in a constrained environment and in coordination with regulators. While countries like Australia, Canada and South Korea have since launched their own versions, uptake in the U.S. has been slow. Arizona launched the first regulatory sandbox in the U.S. in 2018, with Wyoming and Utah following suit earlier this year. We expect more states to jump on the bandwagon, which could lead legislators in Washington to propose a federal system.

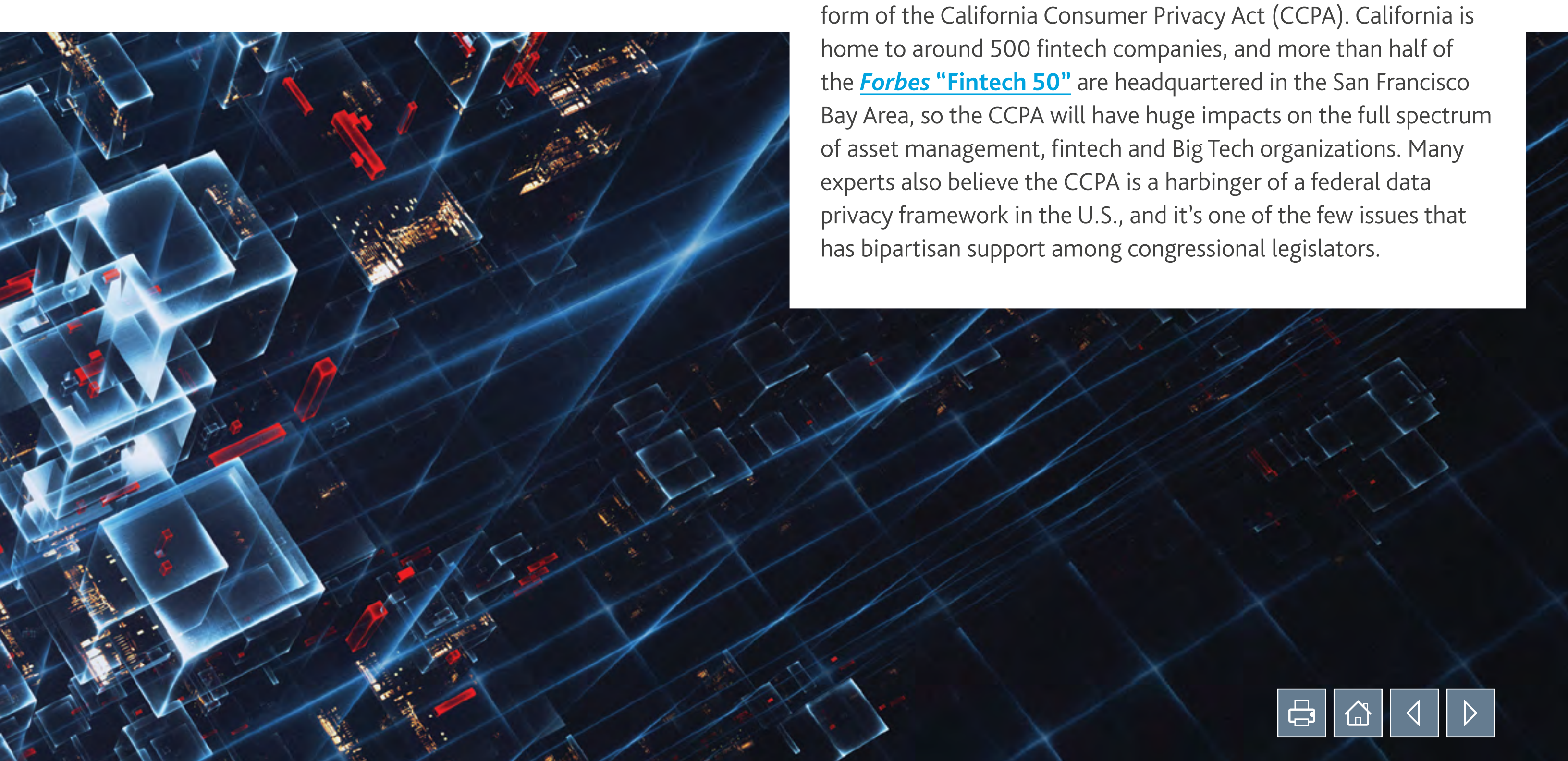
TREND #3:

PRIORITIZING DATA PRIVACY

Storing and distributing personal financial data through fintech applications can give rise to significant cybersecurity risks. It's not surprising then that the asset management industry—and the financial services sector overall— overwhelmingly views cyberattacks and privacy breaches as the most significant digital threat they are facing, according to the *2020 Financial Services Digital Transformation Survey*. The threat of cyberattacks has only increased during the COVID-19 pandemic, as cybercriminals aggressively look to exploit network vulnerabilities while workers access company servers from home. As a result, bolstering cybersecurity is one of asset management firms' top long-term business goals.

In addition to organizations' own cybersecurity efforts, the financial services industry is increasingly subject to regulations to ensure data privacy compliance. In 2017, the New York State Department of Financial Services (NYDFS) enacted its Cybersecurity Regulation, requiring organizations under its jurisdiction to have a comprehensive cybersecurity policy that includes identifying the cybersecurity practices and risks of third-party contractors. In 2018, the General Data Protection Regulation (GDPR) was implemented for all companies doing business in the European Union. GDPR sets out strict privacy rules to protect customers' personal information, along with the potential of hefty fines for non-compliance. This forced businesses in all sectors to overhaul their data collection and policies for use and storage. It also paved the way for even more pervasive data privacy regulations to be introduced elsewhere.

In 2020, some companies face more regulatory action in the form of the California Consumer Privacy Act (CCPA). California is home to around 500 fintech companies, and more than half of the ***Forbes* "Fintech 50"** are headquartered in the San Francisco Bay Area, so the CCPA will have huge impacts on the full spectrum of asset management, fintech and Big Tech organizations. Many experts also believe the CCPA is a harbinger of a federal data privacy framework in the U.S., and it's one of the few issues that has bipartisan support among congressional legislators.



TREND #4:

ASSET MANAGEMENT FIRMS WILL INCREASINGLY TURN TO M&A AND PARTNERSHIPS TO STAVE OFF COMPETITION FROM BOTH FINTECHS AND BIG TECH

While the COVID-19 pandemic forced many asset managers to push the pause button on M&A in the short-term, signs point to a resumption of activity in the near future. In fact, a recent BDO analysis of COVID-19's impact on U.S. bank and insurer valuations indicates that the former had already recovered to 91% of their year-end 2019 value during April, so it's critical for asset management firms to continue exploring M&A as a viable growth strategy. **[Design: insert link to valuation insight when published in June]**

According to Gartner, 80% of traditional financial services firms could go out of business by 2030 due to the rapid pace of change brought about by digital transformation. To stave off this fate, many financial services companies with asset management subsidiaries are partnering with and/or acquiring fintech businesses. Through September 2019, major U.S. banks, including Goldman Sachs, Citigroup and J.P. Morgan, were involved in 24 fintech equity deals, according to **CB Insights**. As their primary profit sources get squeezed by zero-fee fintech competitors, asset management and other financial services companies are using these investments to gain access to the technology and turn a profit if the target fintech business takes off. Fintech companies themselves are also looking to expand their offerings to gain more market share from traditional asset management organizations, and capital infusions from outside investors are allowing them to do so: U.S.-based investment in fintech businesses reached a record $59.8 billion in 2019.

As if the competitive landscape wasn't threatening enough for traditional firms, user adoption of financial services offered by large tech companies continues to rise, with Apple, Google, Facebook and Amazon already offering financial services like payments, financing and mobile wallets. So, it's feasible for Big Tech to compete directly with asset management firms. However, there are high regulatory hurdles that new entrants have to overcome, and incredibly profitable Big Tech companies likely want to avoid the increased regulation that comes with being a financial institution.

At the same time, the fintech sector accounted for just 6% of the total global estimated annual revenue for the financial services industry as of June 2019, **according to the IMF**. So, while the dynamic among fintech, traditional banks and Big Tech will continue to develop throughout 2020, the endgame will depend on increased overall market penetration of fintech solutions.

TREND #5:

MATURING OF THE FINTECH MINDSET

The holy grail for asset management firms will be using digital solutions to create an omnichannel experience for clients—meeting their financial services needs whether through the website, mobile app, call center or in person. However, it's clear from the BDO survey results that the asset management industry is lagging behind when it comes to implementing digital solutions, and this lack of preparedness has left some firms scrambling to service customers during the COVID-19 crisis. With every element of the competitive and technological landscape in flux—from the type, size and capabilities of competitors to new applications for IoT, AI and blockchain—digital transformation strategies must be adapted for changing circumstances. Traditional hedge funds and private equity firms that are lagging behind will have to reckon with the depth and scope of the changes they need to undertake to stay competitive.

This may be the nexus of all of the above trends and developments. As the level of urgency increases among traditional hedge fund and private equity firms, one can expect an acceleration in investment targeting fintechs, as well as in the adoption of new technologies and alternative platforms—including IoT, AI, blockchain, crypto and regtech solutions. Tempering all of this activity, of course, will be the issue of managing clients' data privacy to comply with state, national and global regulations, while also reducing the risk of cyberattacks.

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