

FinTech and Big Data:

Technological Innovations Shaping the Investment Fund Industry

By François DRAZDIK, Head of Administration, Association of the Luxembourg Fund Industry (ALFI)

Technology and big data are radical transformational forces across all industries. Their impact does not stop at the fund industry as they fundamentally change the way investors interact with service providers. They create opportunities for innovation in service delivery and have the potential to enhance the customer experience for a new generation of investors. The past years have seen remarkable progress in FinTech research and development, and numerous initiatives have gotten underway to help asset managers develop business models fit for the future.

Asset managers will expect their fund centre partners to not only keep pace with them, but to push ahead in adapting their practices, products and services to their clients' needs



in an era of global, digital distribution. Investment fund industry actors have long relied on FinTech in many areas ranging from custody and administration services, fund accounting and transfer agency, to reporting, clearing and compliance – to name but a few.

Now, younger technologies such as big data analytics, artificial intelligence and distributed ledger technology or DLT (including blockchain) have also resulted in new areas of FinTech – cue digital investing or robo-advice, although largely in the fledgling stages.

As has been the case with automation, FinTech solutions represent an opportunity to improve efficiency and reduce cost in asset management and may pave the way to new products and distribution channels, benefitting the investor and the wider industry. Skilfully harnessed, FinTech can fix the issue of systems patchworks and can streamline and simplify all too often tangled workflows and bring transparency to performance measurement.

Some of the most promising examples of use in Luxembourg are the following:

The aim in the context of anti-money laundering (AML) and Know-Your-Customer (KYC) requirements is a shared processing model, with a concerted approach to investor screening and its documentation, eliminating duplicate efforts and inconsistency.

Blockchain, alongside other examples of distributed ledger technology (DLT), is in the spotlight in relation to end-to-end shareholder transaction processing. In addition, asset managers will be able to interact directly with investors via third-generation fund platforms, combining robo-advice, trading, settlement, aggregated shareholder reporting and objectives-based performance tracking with the facilitation of social investment and participant forums.

Luxembourg, as home to the largest fund industry in Europe, is active in the domain of blockchain solutions around transfer agency and distribution. Fundchain, launched in 2016 by Luxembourg start-up Scorechain, aims at exploring the potential of blockchains for the fund industry.

In 2017, a number of major financial institutions joined the initiative, with participants now including BIL, BNP Paribas Securities Services, CACEIS, Brown Brothers Harriman, European Fund Administration (EFA), HSBC, ING Luxembourg, Pictet, RBC Investor & Treasury Services, Société Générale Bank & Trust, PwC Luxembourg, Schroders, SWIFT and the University of Luxembourg.

FundsDLT is another key initiative in the realm of asset management aimed at exploring the potential use of blockchains, including AML/KYC solutions.

In July 2017, Natixis Asset Management completed a first real blockchain transaction in fund distribution via this platform, developed as a new distribution channel that saves asset managers and service providers time and money.

Infrachain is an initiative developed at national level that intends to build an infrastructure layer of blockchain technology to be used for pan-European projects. Infrachain's purpose is to foster a trusted and sustainable operational environment for blockchain solutions managed out of Luxembourg. Created as a non-profit organisation in May 2017, Infrachain has been a one-of-a-kind initiative and strives to become a large European node network with hundreds of host operators all over Europe.

Luxembourg is also at the forefront in terms of RegTech solutions looking to gain efficiency and enhance automation in certain regulatory processes such as transaction reporting.

We are also beginning to see an interest in creating funds that invest in cryptocurrencies, using blockchain-based target operating models that may dramatically change the asset servicing scene. Robo-advice currently remains limited by regulatory issues. Hopes are that an enhanced regulatory framework as a result of UCITS V, MiFID II and GDPR, will boost robo-advice by making it safer for investors.

SGG Crossroads

How the finance industry can contribute to a better society

"1 person spending 1 dollar is charity. A million-people spending 1 dollar becomes political, and the needle starts to tremble", Bob Geldof

The inaugural SGG Crossroads event, organized by SGG Group, a leading global investor services firm, and 360Crossmedia, was held in Luxembourg on 26 June 2018. The objective of the event, which was co-sponsored by Deloitte, Carne, ING and Baker McKenzie, was to create a thought provoking platform where members of the industry could reflect on how the financial sector could create a better environment for future generations.

In his opening remarks, Serge Krancencblum, CEO of SGG Group, commented: "I wanted to show the positive contribution of the finance



From left to right: Roelfien KUIJPERS, Serge KRANCENBLUM, Gina MILLER, Yuri BENDER (Financial Times), Bob GELDOF

industry on society in general, and also inspire finance professionals with the outstanding initiatives of our guest speakers. There is a new generation of investors and finance professionals

who do not only aim at maximizing profits but also want to have a positive impact on society." Mr Krancencblum highlighted that, at SGG, the objective is to create a better society and a sustain-

able business, two concepts which go hand in hand. Leading by example, he announced that he is pledging 10% of his future exit revenue to charitable causes.

Sir Bob Geldof explained how he was able to leverage his 'rock star' status for philanthropic ends and presented the genesis behind the Live-Aid and Band-Aid campaigns. "1 person spending 1 dollar is charity. A million-people spending 1 dollar becomes political, and the needle starts to tremble. With a further push, it brings about change," he stated. He encouraged the public to consider investments in Africa, showcasing the results of his private equity fund – 8 miles – in bringing about positive impacts in the communities in which the fund invests.

Gina Miller, Founder and head of SCM Direct, a disruptive asset manager, called for much deeper transparency in the financial industry and an inclusive capitalism. "Divided capitalism has not created societies where people thrive. Our duty is to deliver a virtuous circle

of value creation, customer confidence and self-fulfilment," she stated.

Other speakers at the event included Nev Hyman, who presented Nev House, a sustainable social enterprise using recycled plastic to create low cost homes, Roelfien Kuijpers, Member of the Executive Committee at DWS NY, who made the case for increasing the interest of investors in responsible investments, and Myriam Vander Elst, Vice President and Head of Europe at EPIC, who underlined the changing nature of philanthropy and the need for transparency in this sector.

In addition, Patrick Scheurle, CEO of BlueOrchard Finance, presented impact finance and how populations in the developing world can benefit greatly from access to financial services; Roger Hartmann, Board Member at Sgope SA, emphasized the importance of compliance and risk for the financial sector, while Itzik Amiel, CEO of The Switch, reminded the audience of the importance of human interaction in creating a better society.

How will the Fed reduce their balance sheet?

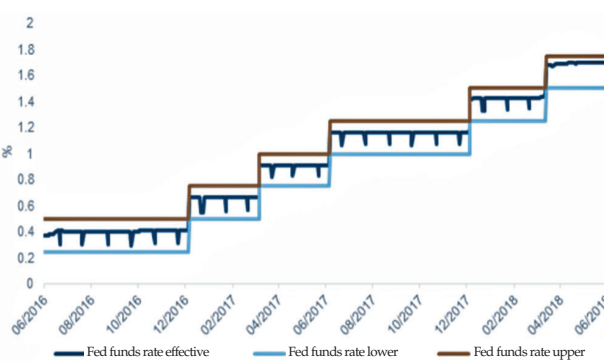
By Christopher ELLINGER, Assistant Portfolio Manager, Money Markets, Fidelity International

A few unusual paragraphs in the minutes from the May FOMC meeting have caught the attention of market participants. It has raised some bigger questions about the length of time over which the Fed will be shrinking their balance sheet and their plans for the future operation of US monetary policy.

The FOMC currently sets a target band for the overnight rate for uncollateralized lending between banks, the fed funds rate, and also sets the interest rate that they pay on excess reserves, the IOER. The IOER is currently set to be equal to the upper end of the target band.

Since the beginning of the year, the federal (fed) funds rate has steadily risen towards the top of its target range. In response, the FOMC minutes reveal they are likely to adjust down the interest rate they pay on excess reserves (the IOER), relative to the top of the target range, by five basis points to be more confident of keeping the fed funds rate within the target range.

Chart 1: The fed funds rate has been creeping towards the upper bound of its target range this year



Source: Thomson Reuters, Fidelity International, June 2018

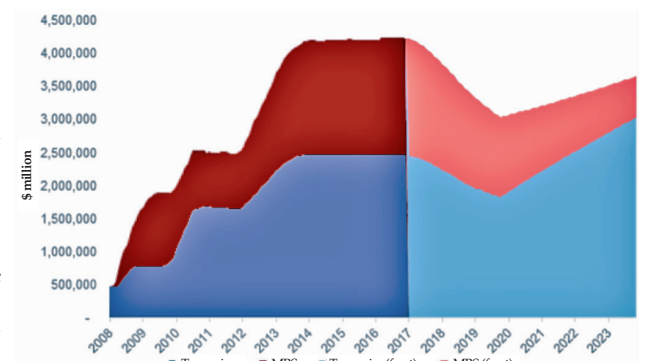
The main driver of the move higher in the fed funds rate has been increased T Bill issuance by the treasury, which has driven up bill yields and pushed up short term rates as well. However, the bigger worry for the Fed is that some of the upward pressure on money market rates has been due to reserve scarcity. That reserve scarcity could be happening so early in the process of unwinding quantitative easing would be evidence that the natural level of reserves in the system is far higher than previously thought. It implies that they would have to taper or suspend the

balance sheet reduction far earlier than projected.

The Fed's own projections include a range from \$400 billion of reserves at their minimum or 'normalised' balance sheet, which would happen in 2023, to \$1 trillion of reserves, which would happen in 2020.¹ After the balance sheet hits its minimum size, the Fed will become net buyers of Treasuries again. If the natural level of reserves is at the high end of the range, as we suggest above, it means they will become buyers sooner rather than later.

Ultimately, the recent moves have brought forward the decision of how the Fed will run monetary policy in the long run. The trade-off between the options is the degree to which the Fed can reduce the balance sheet. If they want to operate with abundant excess reserves, they will control the fed funds rate by setting IOER within the target range. This will limit the extent to which they can reduce the balance sheet, and mean that they become net buyers of Treasuries sooner. If they want to operate with a scarcity of reserves, IOER will act as a floor to fed funds and

Chart 2: Projection for Fed balance sheet with minimum \$700bn reserves



Source: Fidelity International, June 2018

the discount window as a ceiling for the target range. This will allow the Fed to run down their balance sheet for longer, but also implies scarcer reserves, lower money supply and tighter financial conditions globally.

The decision on how to run monetary policy will, in large part, come down to how determined the Fed is to significantly reduce its balance sheet.

1) https://www.newyorkfed.org/medialibrary/media/markets/omo/SOMAPortfolioandIncomeProjections_July2017Update.pdf