



# How can FinTech facilitate fund distribution?

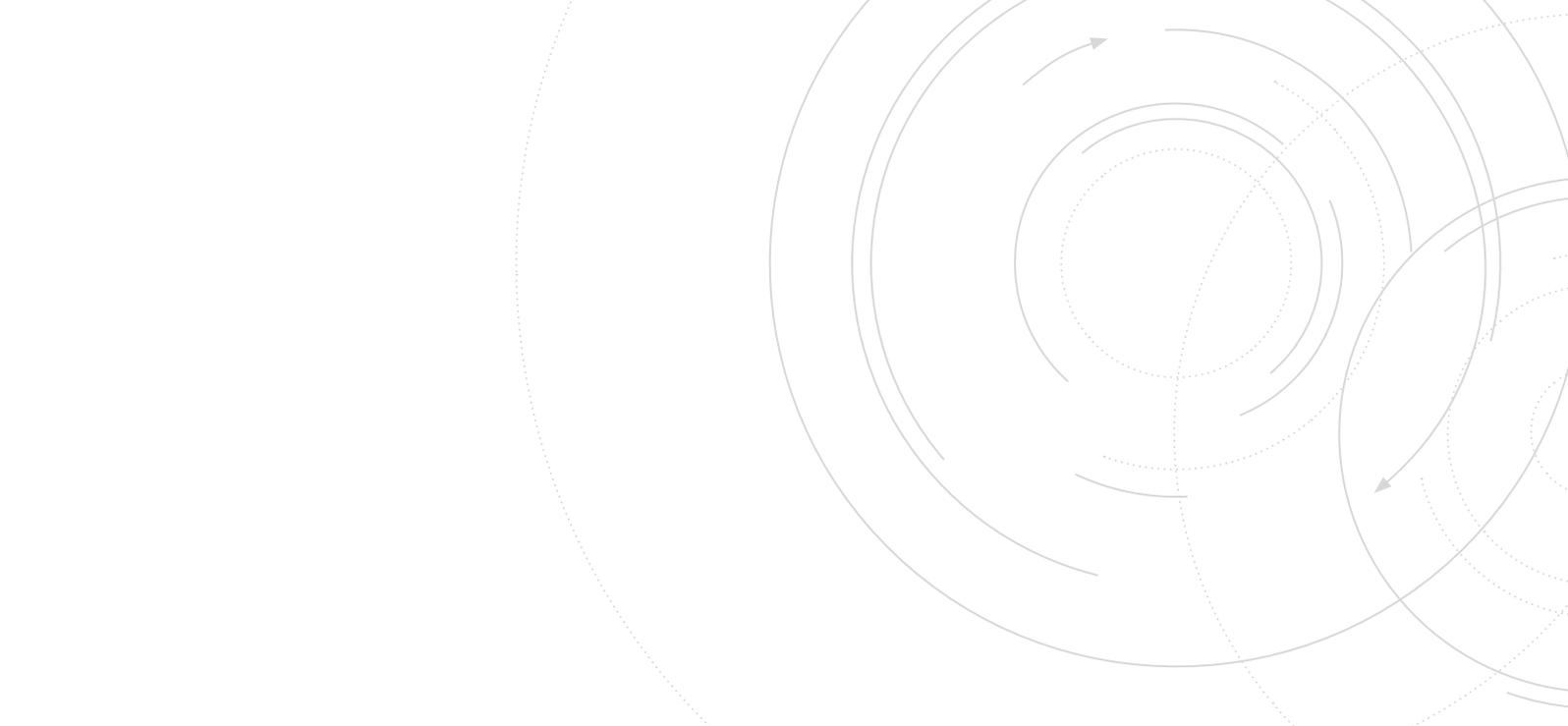
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FinTech is more than a buzz word. It is a game changer in the operating model of asset managers, distribution intermediaries and service providers. New investor behaviors are the driver of change and the investment management ecosystem must further increase efficiency and provide a better customer experience. Luxembourg asset servicing firms have a major opportunity to help asset managers and distribution intermediaries to succeed in the change.



Industries are constantly evolving but incremental changes are hardly noticed. Sometimes however, industrial sectors undergo radical changes, where the process of incremental evolution is significantly disrupted by outside technological, demographic, regulatory, or economic forces. In this article we seek to describe the impact of FinTech on the distribution model of the asset management industry and the strategies to be adopted by incumbent actors. Today the FinTech surge is starting to reshape the financial sector on a global scale with a flourish of new actors attracting significant attention from markets, customers, and investors. Several driving forces can be identified:

- **New technologies have emerged**

- *Machine learning* will enhance prediction-based portfolio management techniques.
- *Digital investment platforms* and robo-advisors will become more and more popular, especially in execution-only-driven Direct-to-Consumer (D2C), and will support investor education about products and their related risks.
- *Peer-to-peer (P2P) lending* is a technical innovation as such and is also on its way to become an alternative asset class.
- In the long-term, *Blockchain* has the potential to make trading and post-trading processes much more efficient, improve transparency and audit trails, and eliminate intermediaries.
- Throughout the emergence, it is important to remember that increased digital interaction of online platforms will increase *cyber risk*.

- **The re-wired investors** - The new generation of investors will redefine the service level expected from asset managers by imposing more interaction with the brand in order to ensure they share the asset manager's values. There is also a strong need for online and enhanced execution platforms including market insight and wealth reporting as well as social investment interaction with peers. The access to socially responsible investment and hedging capabilities will be valued over performance. All this is of course expected at low cost.
- **Big Data and analytics** make sense of data and can produce descriptive and predictive analytics on investor behaviors, performance measurement, market intelligence or risk metrics. Big Data is a reality and offers a lifetime opportunity for investment management actors to make sense of the zettabytes of information at their disposal to create added value and digital wealth reports, market intelligence and peer comparison insights to the end investor.
- **Uncertainty around FinTech regulation** - Regulation in investment management is still ongoing. The historical ecosystem is subject to a systemic shift via AIFMD, UCITS V, MiFID II, AMLD IV, CRD and CRR, and PRIIPS—to name a few. While investment management actors are struggling to regulate the existing operating model, FinTech innovation introduces additional regulatory gray areas (such as new payment entrants and Blockchain).
- **Emergence of RegTech** - The concept of RegTech has emerged to propose solutions to the market to gain efficiency in non-subjective and labor intensive regulatory processes.

In light of the discussed drivers, we have identified practical areas where the Luxembourg market players could seize opportunities with FinTech innovations. Luxembourg has a very strong investment fund and private banking sector efficiently working together for the prosperity of the market place. Transfer agents, order management platforms, central administrators, and custodians have a major role to play in the FinTech change. Luxembourg actors must actively drive FinTech innovation locally and engage with disrupters, modernizers and enablers in order to be ahead of developments, adapt their operating models with agility and avoid imposed innovation from abroad.

All of these actors sit on an impressive amount of client, market, and portfolio data. With enhanced data management capabilities offered by FinTech, Big Data is no longer a buzzword for investment management but offers the possibility to assist asset managers to respond to investors' needs and further increase efficiency in operations. Luxembourg asset servicing providers have the necessary scale and technology to develop and offer white labelling services to their asset management clients and their intermediaries.

Product management and marketing are core functions of asset managers. These areas are subject to a strong need for technology which requires the scale or focus that all asset management houses do not necessarily have. Luxembourg asset servicing actors can play a key role in this area to give asset managers access to white labelling technology in the form of online order management capabilities, risk metrics, and performance attribution online reports, as well as investment advisory algorithms based on investment patterns and investor behavior, digital payment capabilities, and market insight reports.

The mid and back end of the investment management value chain is the core activity of transfer agents, custodians, order management platforms, and fund administrators. Blockchain is the most disruptive innovation in this area. Its shared ledger and smart contract based technology can theoretically disintermediate order management, recordkeeping, ownership verification, settlement and clearing,

payments and corporate actions. However, we believe that the disruption will not happen in a "big bang" mode and that a hybrid asset servicing model will be implemented by the historical asset servicing providers to leverage the benefits of Blockchain. In the more immediate future, Luxembourg service providers have a key role to play in further developing the automation of reconciliation processes, order aggregation, management and clearing industry standards and online KYC services. In order to avoid the co-existence of different order management models using different Blockchain applications, Luxembourg actors should launch a joint industry initiative to create a harmonized Luxembourg Blockchain asset servicing brand.

Luxembourg should also create a digital passport industry initiative to further enhance efficiency in investor identification. We also see considerable room for offering managed services to investment funds in a one-stop-shop model. Asset servicers can seize the opportunity to offer bundled fund services to asset managers in areas such as fund setup and liquidation, fund distribution and registration support, operational tax management, Know Your Customer/ Anti-Money Laundering/Combating the Financing of Terrorism (KYC/AML/CFT) and, last but not least, RegTech. RegTech is the concept of using data management and other FinTech innovation to provide efficient and cost-effective regulatory services to asset managers and their intermediaries. RegTech will never become a "push the button" regulatory compliance solution, but will offer the opportunity to create efficiency in labor intensive and non-subjective regulatory readiness tasks. A few examples on where RegTech could be an opportunity for asset servicers are AIFM reporting, European Markets Infrastructure Regulation (EMIR) and transaction reporting in general, regulatory and tax watch, Solvency II look-through reports, regulatory health check tools, case management tools and risk data warehouses. The Luxembourg ecosystem should join the venture to be at the forefront of RegTech innovation. Helping asset managers to navigate the regulatory changes adopting the latest technologies will further strengthen Luxembourg's competitive advantage in the asset management industry.

We are convinced that algorithmic-based robo-advisory tools will be very successful in the retail area in the context of evolving and execution-only driven D2C. Institutional investors also show interest in this technology, as it will allow them to offer it to their execution-only end clients. Luxembourg has all the necessary requirements to play an active role in this segment. A local market exists in second and third tier asset managers' appetites for white-label robo-advisory technology and execution-only services offered by local wealth managers. The FinTech environment in Luxembourg can rely on one of Europe's strongest IT infrastructures and the local establishment of FinTech actors.

To conclude, within the next few years, we foresee the advent of a flourish of new companies in the sector with technological solutions streamlining the current operating model and addressing the needs of a new generation of investors. In order to stay successful incumbent firms will need to adapt to this new competition by either developing their own technological solutions, cooperating with FinTech companies or absorbing them in their business model. Asset servicing firms have a major opportunity to aid asset managers in this technological shift. Luxembourg, as the world's second largest investment fund domicile has a once-in-a-generation opportunity to reimagine and modernize its distribution and asset servicing model to address market and operational challenges.

Luxembourg's investment management ecosystem should join forces to explore industry initiatives in terms of enhanced online trading platforms, white-label data analytics, managed services, RegTech, Blockchain, or digital distribution passports.

*To read more on the impacts and drivers of FinTech on fund distribution, consult the whitepaper produced by Deloitte for ALFI.*

#### **To the point:**

Luxembourg's investment management service providers should take a proactive approach and use Fintech and Regtech innovation to offer white-label solutions to their asset management clients and their intermediaries by:

- Applying data analytics to the vast amounts of available data in order to improve investor segmentation, provide market intelligence, and facilitate D2C connectivity
- Optimizing processes in areas such as cash processing, settlement, reconciliation, and tax management
- Offering one-stop-shop management services for investment funds

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