



PERSPECTIVES

PODCAST: Fintech Opportunity in the Retirement and Financial Services Space

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Technological innovations have permeated every aspect of our lives, including the way we save and invest. Franklin Templeton Investments President and Chief Operating Officer Jenny Johnson and Empower Retirement President and Chief Executive Officer Ed Murphy discuss the impact of new technology on the financial services industry, particularly in the areas of wealth management and retirement planning.

Here are some highlights of their views presented in the [podcast](#):

- **Ed Murphy** on fintech innovation: Robotics are key for us because we want to take away mundane tasks and redirect the highly paid, highly skilled human capital to be more responsive to the customer.
- **Jenny Johnson** on artificial intelligence: AI is all about proving or disproving a hypothesis. It will be active managers who have a gut feeling about something and being able to prove or disprove whether or not they think that hunch is correct. I think that's going to be a big area of growth.
- **Ed Murphy** on a culture of innovation: You have to allow for risk-taking and experimentation. People need to know that if they come up with an idea and they're asked to run with the idea and it doesn't work, they're not penalised for failure.
- **Jenny Johnson** on technology: Technology is part of what we do every day. We're in the fourth industrial revolution. If you're not thinking about how to ride that wave up front, then it's a threat. But It's also a really cool opportunity for us to serve our clients at a level that we've never been able to before.

A podcast transcript follows.

Host/Richard Banks: Hello and welcome to Talking Markets with Franklin Templeton Investments: exclusive and unique insights from Franklin Templeton.

I'm your host, Richard Banks.

Ahead on this episode, a look at the impact of new technology on retirement and financial services.

Host/Richard Banks: Ed Murphy, president and chief executive officer of Empower Retirement, on what makes fintech a major opportunity and the customer will ultimately benefit.

Host/Richard Banks: Speaking with Ed and Jenny is Scott Parker, principal at Deloitte Consulting, who focuses on retirement and wealth management markets of the financial services industry. Let's take a listen to their conversation.

Scott Parker: Jenny, I'll start with you where do you see the biggest impacts fintech is having within the financial services industry from your lens?

Jenny Johnson: Every part of our business: how you manage your money, how you gather clients, how you service clients, how you process some of the back office. I mean, all of those things are being disrupted. So what are the technologies? You know, the thing with technology innovation is that if you look at history with all the major technology innovations, whether it's the printing press, whether it's electricity, what people first do with it—and literally, the printing press, it was 100 years that they did this—is they just speed up what they already do. So at that point, you know, people were writing manuscripts, usually religious manuscripts, and all the printing press did for 100 years was actually print those same manuscripts so that there was a greater proliferation of them. It took a while for people to start saying, “hey, listen, we can use this differently; it could be titled for property, it could be flyers for information.” So, we're still in a bit of the stage of just speeding up what we do, believe it or not.

And it's really important because we all feel it. There's complete compression on fees. So you better be more efficient about how you do it. You know, bots are a part of every firm, they're thinking about it. They're all about being more efficient at what you do today. I think on the client servicing and the advice side, we believe that the robo advisor does not replace the financial advisor.

You know, if you recall with Turbo Tax when it came out, everybody said that that was going to completely eliminate all CPAs [certified public accountants]. Who are the number one users of Turbo Tax? It's CPAs. And Franklin operates—we have clients in 170 countries, offices in 35 countries. We kind of see the 80/20 rule: 80% of the people want advice, 20% want to go to direct. And frankly, it doesn't really change that much no matter where you go. So, we think that what it does is—it's just going to allow that advice to be much more customised, using both technology and the ability to have some of those personal interactions that helped to really understand clients' needs at a level that today, perhaps, advisors didn't have the ability to do. So, we think that's where it becomes very important on the advisor piece. And then if you think about investment management processes, I'm going to put them in just three basic buckets. You have passive, which is, you know, kind of a single rule-based passive. You have what some will call smart beta. And then the final is true active management. So, if you think about it today, AI [artificial intelligence], big data, has been hugely valuable in the quant/smart beta space, right? And so it's been applied much more there and we're really scratching the surface on the true active management side.

The real key on the data science, is what unique raw source of data do you have? And then, how are you applying that algorithm to be able to gain insights that historically are different from others? In the old days, everybody kind of had their access to Thompson Reuters, Bloomberg—you got models and then you tweaked the model based on your own views. Now it's going to be what raw sources of data do you have to be able to get you insights that others don't have? And how long does it take for others to catch up?

And the final thing, many people think that like ex-machina, that it's going to be this very thoughtful kind of AI. The reality is, AI is all about proving or disproving a hypothesis. So today, it will be active managers who have a gut feeling about something and being able to prove or disprove whether or not they think that hunch is correct. So, I think that's going to be a big area of growth.

Scott Parker: Yeah, absolutely. Ed, maybe from your perspective, when you think about the retirement, market evolution or revolution of fintech players?

Ed Murphy: I think it's probably a little bit of both. You know, I think some of the companies are more evolutionary-type players, in the sense that they're typically finding one aspect of the value chain and looking to enhance it, or in some cases maybe disrupt it. So I think it's more evolutionary. On the revolutionary side, I mean, I think there are things that we may see, with respect to legislation or regulations, that I think could prove disruptive and create tremendous opportunity for the industry.

Scott Parker: Maybe Jenny, take us through Franklin's perspective or what your approach is to looking at the ecosystem of players and thinking about how you are able to capitalise on some of the things that they're developing.

Jenny Johnson: We have a three-pronged approach to how we think about fintech. So first is, as you mentioned on the data science, you know, we do think for the investment teams, it's much about what raw sources of data sets do you get that your competitors don't have. The fact that we've got feet on the ground in 86% of the world's GDP [gross domestic product], we think is an advantage to us gaining some insights.

And so what we've done is we've created a centralised data science group, creating a data leg, being able to go out and get sources of data. But it's being driven by—it's a hub-and-spoke model, so embedded in the investment teams is a data scientist who's talking to research analysts trying to understand what ideas they have, what they're wondering about. An example in India, we have a local asset management business in India and the equity team that was covering transportation was trying to figure out how airports—because they were being privatised—whether the traffic was growing or not. And, you know, how they could understand comparing one airport to the others, there's no real information around that. And so they built a model where both the investment analysts working with the data scientists to come up with sources of data that they could pull in to be able to build a model about prediction on flows in airports. And so it's that kind of conversation between the data scientists and the investment team that we think is so essential. So we're doing that on the investment side.

Secondly, we've set aside a strategic investment fund, which is to just invest in some of these startups more about the technologies that we think could be disruptive. So it gives us kind of a front-row seat. It's much less about what's the investment return. We're not looking for the next great Google investment. We're looking to make sure that we understand how that disruption is starting to infiltrate in our business. And by picking things like blockchain, like natural language processing, like bots, you know, that are startups around that, that we can invest in. Embedding an advisor from our team within that firm, we think, gives us a good opportunity to see what's coming. If you look at a lot of the incumbent technology companies like Microsoft, most of their development isn't coming internally, they're buying it out externally. Pharmaceutical companies, buying out external. And then the hardest thing in an operating technology department is introducing any software change.

It probably takes twice as long to get anything rolled out. Whereas an entrepreneur never has to deal with any of that stuff. As a matter of fact, somebody said to me, "boy, if entrepreneurs actually had to follow all the procedures technology departments do, we'd never have anything new hit the market." What we've done is we've ring-fenced a group of development people who are building, really what we think would be fail-fast type applications who are much more entrepreneurial in how they think about it versus being built into the process, to try to speed up some of our own innovation internally.

Ed Murphy: I would say we're doing something similar to what Jenny referenced, in terms of establishing pockets of innovation around the company where we're very much taking an outside-in approach. I would say the other thing we've done is we've really sort of beefed up our business development efforts in a way that didn't exist if you go back a couple of years ago. So we're looking at emerging technologies, we're being proactive and evaluating and assessing those technologies to see if there could be a potential fit. And it goes back to the point that you made earlier about. It's more about enhancing the value proposition and providing more of that end-to-end experience. I'd say the third thing is you know, if you look at a company like Empower with 38,000 sponsors and nine million participants, if we link up with a fintech firm or a startup and we partner with them, in many instances, we have the opportunity to put that company on the map. So, what they don't have is they don't have distribution, that's what we have. And for that, we want to get paid. So, we'll either buy an interest in the company, we'll either take warrants, but those are the types of things we're doing. I think, from our standpoint, we prefer the partnership route because we can get to market faster, and at the end of the day then, it's really all about how do you bring this together in a way that's seamless in a way that's elegant, that delivers action and outcome, right? Because that's the tough part, right?

Scott Parker: Ed, any perspective on, as you partner with these firms, what's successful, what hasn't been successful and how you approach not taking your enormous organisation and suffocating these startup fintech innovation-type firms?

Ed Murphy: Yeah. Well a couple of things. I mean, at first, I think you've got to free up capacity. So, people have to give up their day jobs to really focus on working with that partner and advancing that product or that service, so you can get it to market quickly. The other thing though is, when we look at partnering, we want to make sure there's shared objectives in terms of what we're trying to accomplish. And what you'll find a lot of times is, you might have a partner or potential partner that has a great product or service, but they're looking for an exit.

So you introduce a product or a service—and we typically white-label everything—but you introduce something like that to your customers and you find six months to a year down the path, we've got to unwind. So that whole due-diligence process, not just around technology, but understanding what their long-term intentions are really important to us, before we seal the deal and partner. But I would say internally, it kind of goes back to the point Jenny made, you have got to allow for risk-taking and experimentation. And people need to know that if they come up with an idea and they're asked to run with the idea and the idea doesn't work, that they're not penalised for failure. And so that's a cultural thing. And I would say for us, that's a work in progress, we're not there yet, but it's something we're actively pursuing.

Scott Parker: Where are we in adopting some of the robotic capabilities and how far do we have to go to, again, drive efficiencies, leveraging technology?

Jenny Johnson: We have a local asset management business in India had all these bots going. But I think the industry has a long way to go to just do efficiencies in just cleaning up some of the very mundane-type work.

Scott Parker: Yeah. How about in retirement services specifically, Ed?

Ed Murphy: Yeah. And we've got a pretty active robotics program now and in some ways, the cost to serve keeps going up. Our information data security team has gone from seven people to 53 in three years. Now I can spread that cost across nine million participants, but imagine if you have to make that kind of human capital investment in your sub scale? That's a whole different conversation in terms of where this industry is heading, there's going to be a massive shakeup for sure. But I just would say that robotics are key for us because what we want to do is we want to take that highly paid, highly skilled human capital and we want to direct it to the customer. An example would be return check processing. Doesn't sound very fun, but we used to have people that did that, right? So, to the extent you can have a bot do that and you can be more efficient, you can be more accurate, you mitigate risk, but more importantly, you free up that capital so that those folks can focus on not only being reactive and responsive to the customer, but ideally being proactive in identifying issues and concerns and getting in front of them. So, I would say for us, we're probably in the first inning, second inning of our robotics program, but we have deployed several bots at this point.

Scott Parker: Are there other pockets of what a retirement provider does for its plan sponsors, advisors, participants, where you think the point solutions will have more of an impact than others?

Ed Murphy: I think it's across the value chain. I really do. I mean, we've got to reduce cycle time and you know, I'll challenge my team to say, "look, three or four years ago, in a particular segment, we might've done \$4 billion in sales. Today, we'll do US\$9 [billion]. Four years from now, we'll do US\$21 billion-\$22 billion in transfer sales. The implementation process, the enrollment process to support that kind of volume can't be the same. It has to change fundamentally in order to meet client expectations and obviously do it in an efficient way. So I would say we're looking at every aspect of it. To your point, from the onboarding part of it, to the ongoing servicing part of it, to the distribution side of it. Absolutely. And in some cases, it is an outside partner that's going to help us achieve that objective.

Scott Parker: And how about in the record-keeping space specifically, how ripe is the industry for innovation with core record-keeping platform?

Ed Murphy: Well I think it's a really good question. I mean most of the industry is on a mainframe, right? 30-year-old technology. So legacy systems, you're burdened by those systems, you're burdened by the layers and layers of middleware. You got to be in the server-based business today, right? So, we'll move 85% of our applications to the cloud. As we do that, if, if we have high capacity or high demand, I mean all we have to do is add another server, right? I mean it's pretty straightforward. I think that's really important to be able to respond to the changes in the market and to be able to support growth. You've got to have that ability to scale. I do think that those legacy systems can be cumbersome and can be challenging for these entrenched incumbents to be able to even embrace some of the technologies. Right?

Scott Parker: Jenny, talk to us about blockchain.

Jenny Johnson: I think the challenge with blockchain is that it was synonymous with cryptocurrency. Forget cryptocurrency and think of blockchain as just a digital certificate of ownership, right? If you just think about it as a digital certificate of ownership, it could be anything. And if you think about why, ultimately, people will be motivated to use blockchain I'd say it's three things.

The block is all parties who are involved in the transaction. It got a bad name initially because it was associated with nefarious kind of behaviors. Well, that was because there was no AML [anti-money laundering], KYC [Know Your Customer] identification in creating the crypto wallet where the block is, but that's going to go away. You're going to start to see that anybody who has access to that type of blockchain is going to have to go through a process. And once you have passed the KYC, then you are forever tied to that transaction to block, it never goes away. So blockchain is each block of the transaction stays witness. So that's one. Number two, as you mentioned on cybersecurity, I mean, the reality is it is going to be a real issue.

And what blockchain does is, because it's a distributed ledger, the source of truth is distributed it out in a bunch of places. It could be 1,000 places, it could be 100 places. And so if somebody breaches it from a cyber standpoint, the good news is you have a bunch of other sources of truth. So that becomes a good defence from a cybersecurity standpoint. And then I think that it's going to be a much faster way to just transact.

You're starting to see a bunch of pilots around this because everybody's trying to kind of figure it out. And what's going to happen is almost overnight those pilots are going to start to link to each other and people are going to say, "wow, where did this come from?" It's just hard to know that point of the hockey stick where it's all sort of pilot to suddenly it's a big deal. I just think this is a very real thing.

Scott Parker: Ed, maybe talk about retirement business—blockchain in retirement—are we at that hockey stick or are we a few years out and where within retirement system?

Ed Murphy: I think it's still sort of in its mason form, but I know, from our standpoint, we would like to see it mature a little bit further, but I think from a security standpoint, from a transparency standpoint, think about it from an intermediary who's placing trades, or think about it from the standpoint of someone like us who's processing trades, reconciling trades, clearing trades, that whole process will be shortened. And then you sort of potentially eliminate the middleman, right? So, you're not as concerned about the data integrity or provider, as much as you would be today, for instance. So, I think it's here to stay. Obviously, it's making some fairly significant inroads in the payment processing and banking space, and I think for us—being in the technology data recordkeeping business—I think it's going to have real application. We're not jumping in with all hands and feet right now, but we are monitoring it and evaluating it. We would like to see it mature a little further.

Scott Parker: Back to the broad fintech, threat or opportunity, Jenny?

Jenny Johnson: Look, technology has been just a part of what we do every day. It's just that it's not linear as far as what changes, and we're in the fourth industrial revolution. So, if you're not thinking about how to ride that wave up front, then it's a threat. It's also a really cool opportunity for us to serve our clients at a level that we've never been able to, from a customisation. And so that becomes just a huge opportunity.

Ed Murphy: Yeah, I agree. I see it more as an opportunity to enhance and strengthen the value proposition. But I think, you have to be fleet of foot and you've got to move fast in evaluating some of these capabilities and look at where there's opportunities to really strengthen the offering to the client. Oftentimes that is partnering or, or acquiring capability, as opposed to trying to build it internally.

Host/Richard Banks: That's it for this edition of Talking Markets with Franklin Templeton. Thanks to all our contributors, and thank you for listening. If you've enjoyed these insights and would like to hear more, check out our archive of previous episodes and subscribe on iTunes, Google Play, or just about any other major podcast provider. So until next time when we uncover more insights from our on the ground investment professionals, goodbye!

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