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Nobel Perspectives: On a post COVID-19 world

Professor Robert Merton highlights the opportunities and challenges that FinTech presents to the financial services sector

As part of the UBS Nobel Perspectives program, our webinar series allows you to pose questions directly to Nobel Laureates in Economic Sciences.

UBS Nobel Perspectives cuts through the noise, addresses the questions shaping our world, and holds the largest content library of Nobel Laureate interviews.

Professor Robert Merton won the Nobel Prize in Economics Sciences in 1997 for his work in establishing a new method to determine the value of derivatives; a generalization of the Black-Scholes formula which paved the way for economic valuations in many areas. The majority of his research has been in mathematical finance theory. Robert C. Merton is the School of Management Distinguished Professor of Finance at the MIT Sloan School of Management and John and Natty McArthur University Professor Emeritus at Harvard University.

Key webinar takeaways

- Digitalization of financial services, often called FinTech, offers enormous global opportunities for new and improved services and substantially lower costs, with disproportional improvements accruing to those who are underserved by current standards.
- To realize that potential, innovation design based on 'best practice' will not be good enough, and the important challenges to implementation must be addressed as part of the design.
- Successful realization of FinTech-enabled opportunities faces material challenges and there will definitely be financial service industry 'winners' and 'losers' from its successful implementation.
- FinTech innovations will create disruptive challenges for users, providers, advisors and regulators of financial services but will also create potentially significant opportunities for them as well.
- While there are some parts of financial services that do not require trust, key areas such as financial advice can only function if there is trust.
- Technology by itself does not create trust and so FinTech cannot succeed without it.

Moderator: Evan Brown, CFA, is Head of Multi-Asset Strategy in the Investment Solutions team at UBS Asset Management. In this role, Evan drives macro research and tactical asset allocation investment process across asset classes. Additionally, he drives thought leadership to clients through advisory mandates and investment publications.

On digitization, FinTech and trust

It's been somewhat overshadowed in recent times because of COVID-19, but there is no doubt that the technology and FinTech area is going to have a huge impact on financial services around the world, offering enormous opportunities for new and improved services and substantially lower costs with disproportional improvements accruing to those who are underserved by current standards.

FinTech will succeed most easily in areas of financial services involving calculations, processing, payments and record-keeping, where performance can be readily tested and verified, and in any activity in which transparency can be adequately substituted for opaqueness. Truly transparent services do not require trust. Services which can be fully verified need not be transparent and do not require trust to be adopted.

FinTech will be challenged to succeed in offering services and products that are inherently opaque, i.e., cannot be made transparent, such as financial advice, solutions and many complex integrated financial products.

FinTech increases time efficiency and lowers cost by substituting ‘black box’ technology for human efforts of both advisors and providers but in doing so it also increases opacity, which in turn makes trust an even more important and valuable asset. Technology by itself is not a substitute for trust and competence.

FinTech’s success will thus drive increasing value for the trusted advisor, provider, consultant and overseer. Instead of technology sold directly to consumers, the process will have technology sold to trusted advisors who can evaluate and verify the technology, and consumers, who will let the advisor use the technology to make decisions for them because they trust their advisor.

Improving regulatory innovation to create and restore trust

Consumers of financial services lost trust in their providers and their regulators during the 2008 Global Financial Crisis. Financial advisors and institutions with business strategies based on restoring trust by minimizing conflicts of interest, such as fee-only independent advisors, will disrupt traditional product-based wealth-management models with captive distribution broker and adviser systems. Regulation is important and can help establish trust.

Fiduciary duty responsibility for financial advisors can be strengthened to promote the creation of trust, but with significant clarity on the meaning of ‘client’s best interests’ to provide balance to protect the advisor from too much litigation risk.

Regulations should encourage transparency and the avoidance of conflict of interests. For example, mandated disclosures should be matched to the user of the information. Disclosures to customers should contain only information deemed ‘meaningful’ to the customer, to avoid inducing frustration or poor decisions.

Risk definitions and measures consistent with the purpose or goal of the product or advice offered. For example, risk of retirement-income-goal product or portfolio measured in terms of volatility of its retirement income and not the volatility of its value.

Disclosures of expenses to permit meaningful comparisons among similar alternatives is another important area. Expenses disclosed for a product or service could include the total embedded fees of the product as well as the marginal contribution to expense from service or product provider.

Regulations should be routinely reviewed for their ‘unintended’ consequences.

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