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Responsible Innovation in Distribution: Three Channels for Asset Managers

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Responsible innovation can mean different things to different people.

Whatever its final definition, its two integral concepts — innovation and responsibility — need further explanation.

Innovation means change. What does that look like? It could be the transformation of how work is conducted, through the use of technology, for example. Or it could be a shift in thinking, perhaps integrating non-financial criteria into an investment process.

Either way, the goal is to derive some incremental benefit over the status quo.

Responsibility requires considering how such innovation impacts all stakeholders. To be clear: The asset management industry needs to innovate in a responsible manner. Responsibility may mean different things to different people, but however asset managers define it, they must take a position, embed that position in their mission, and stick to it. This is a great opportunity for the overall asset management industry to spell out what it stands for.

When it comes to the distribution perspective, there is a distinction between the two types of clients: the professional and retail investor. The former wants direct access to the factory — the portfolio manager or the asset management group. The unsophisticated retail investor, however, needs intermediated distribution, with platforms, advisers, and the like. Such a potentially long communication chain should prioritize simplicity. Transparency on incentives and potential conflicts of interest is a critical corollary. This differentiation is essential when we consider the use of data and artificial intelligence (AI), the role of infrastructure in distribution, and just how close investors should be to the factory.

With these issues in mind, during our fourth Asset Management Innovation (AMI) private workshop last September, we discussed three channels that offer potential pathways for asset managers to foster responsible innovation in distribution.

Asset Management Innovation (AMI) Workshop Participants

Alon Bochman, CFA	Josina Kamerling	Thomas Rostron, CFA
Amin Rajan	Simon Ramos	Blair McPherson
Julia Susanne Orlich	Peter Rutherford	MJ Lytle
David Wahi	Gerhard Sogl	Pieter Jan Fissette
Olivier Lebleu, CFA	Rhodri Preece, CFA	Hitesh Dattani
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1. Data and AI Applications

Who benefits from the use of data and technology? The asset manager or the client?

On the one hand, responsible innovation requires that the use of the client's data, whether it's about themselves or their online activity, benefit that client. How? By giving a better understanding of their optimal investment portfolio and solutions and what they may need for educational purposes, for example.

But some asset managers have taken used these insights for their own ends, leveraging a client's propensity for short-termism or performance chasing, say, to increase profits. This kind of "innovation" hardly qualifies as responsible.

The power of these sorts of "nudges" is undeniable and digital innovation will only increase it. So the ethical challenge of determining whether data-facilitated nudges are motivated by responsible or irresponsible reasons will be an ongoing one.

This will be especially true in serving unsophisticated retail investors. By offering "free" trading services, for example, platforms are nudging clients to trade more. Does this qualify as responsible innovation? Given the potential to encourage costly and unproductive portfolio churn on an industrial scale, the answer is probably no. Which is why public discussion and regulatory scrutiny around perceived champions of innovation and investors, like Robinhood, for example, have increased.

Moreover, bad data and manipulative technology interfaces do exist, more will be developed, and many will survive "in disguise." This will no doubt lead to negative outcomes for investors.

But such excesses should not undermine the value that new data and technology, properly applied and presented, can add. We need to continue to promote rather than discourage their development.

2. Investment in Distribution Infrastructure

Why hire and retain a salesforce? Given inadequate communications infrastructure, asset managers need one to distribute information to clients.

But on the whole, the industry could streamline this approach and better reach clients through "simple" technology. For sophisticated clients, a well-structured website with the requisite technical data about their investments — say the duration or yield of a specific strategy at a particular time — would be a significant step forward. While the industry has best practices, such convenience is certainly not the norm. Often in the wholesale and institutional segments, clients have to call and email sales representative to receive this data.

Those frictional costs could easily be returned to the client. As platforms develop — and industry players need to collaborate on them — vast amounts of data and multiple delivery standards will be presented with "make up" and other forms of polish. That may force regulators to develop a taxonomy of investor needs, as the EU has done with sustainable investing, and a standardized framework on what data to collect from fund managers. Further efficiency gains could be made if AI and machine learning were applied to that data to, for example, select funds for investors, among other tasks.

For less sophisticated clients, the new digital and data tools should be used for investor education. Often the purview of intermediaries, investor education has had limited impact in the value chain. Educate or sell? As with nudges, that has always been the conflict. But as distribution embraces digitalization and clients engage more directly with asset managers, more education will be required both on a stand-alone basis and among different industry players.

3. The Asset Manager-Investor Relationship

The value-add of a distribution salesforce is a topic of debate today as more levered and effective distribution models are sought. The exchange-traded fund (ETF) business model, for example, has innovative distribution mechanisms but introduces different challenges and layers of complexity.

The total cost of investing in ETFs varies greatly depending on portfolio churn. The tracking error of index replication is not a simple calculation. But from a MIFID II anti-money-laundering (AML) / know your customer (KYC) perspective, ETFs have considerable benefits. Robo-advisory decision-making tools could add additional support, especially for retail investors. That is, if nudging for volume and profit practices don’t prevail.

How other industries establish more direct connections with their clients and customers and how they use technology to accomplish that can inform the asset management industry’s evolving approach. Social medial and podcasts, for example, can help build a more direct link to clients and increase investor engagement. This may reduce or transform the role of intermediaries like distributors as well the asset manager’s distribution team.

The role of intermediaries and distributors has had a big question mark around it for some time. Few industry experts would have bet on their longevity 10 years ago, but distributors have maintained a strong position in the distribution value chain. A generational change might be needed for a disintermediated digitalized relationship between investors and asset managers to become the norm.

The truth is wealth is concentrated among people age 70 and over. For good reason, this cohort may remain attached to conducting wealth management discussions in person or would otherwise rather not perform them online. Such preferences notwithstanding, there is growing evidence that disintermediation could benefit clients through increased productivity and reduced distribution costs.

The COVID-19 pandemic and the associated disruptions and adaptations may have hastened the evolution of the asset manager-investor relationship. Technology stepped into the gap and abruptly changed everyone’s habits. The lesson some may learn is that the personal bond between client and asset manager may not be as essential as they thought. Or the experience may provide a litmus test for investor service expectations regarding technology and personal relationships.

What might this mean for distribution teams? They may need a high degree of sophistication to keep up with the twin challenges of technical change and evolving client relationship requirements.

What's Next?

Embedding responsibility into innovation is not easy. But the competitive advantages of embracing responsible innovation will likely be concrete, substantial, and sustainable.

Achieving real customer centricity is the main challenge, especially with distribution. Appropriate client engagement is what's most essential to encourage "responsible sales." Client data and the use of it to educate rather than nudge a sale are critical elements. Investors should be empowered rather than manipulated. Yet, for asset managers to serve clients' specific needs, they must have the necessary ingredients: the proper technology and standardization and transparency about the products and the incentives.

In this context, AI could prepare the ground in favor of the investor or of more sales.

The goal is finding the correct, equitable balance. Innovative and disintermediated relations between asset managers and investors should not distract from reality: Investment decisions are not reversible and imply a degree of fiduciary responsibility. Virtualization and depersonalization must properly account for that if they are to truly constitute a step forward for all stakeholders.

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David Wahi has led the coverage for some of the top global asset managers in the Financial Institutions Group at Santander CIB. He joined Grupo Santander in 2009, working in leveraged and syndicated loans origination for Europe, based in Madrid. Prior to graduating with an MBA from London Business School / HEC, Paris in 2009, Wahi worked for Merrill Lynch Investment Managers for seven years as part of the institutional clients division covering mid-large pension fund mandates. He also

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worked a year with the Northern Trust Group managing the key prime broker relationships with the bank. During his MBA, Wahi worked closely with the previous CEO of 3i Private Equity group as a consultant and also did a brief stint with a fund of hedge funds boutique in Paris. Wahi enjoys golf, philanthropy, outdoor sports, travelling, and is also a keen car enthusiast.

2 thoughts on "Responsible Innovation in Distribution: Three Channels for Asset Managers"

1. — **Chris Pederson (https://schuchert.com/) says:**

   23 February 2021 at 16:37 (https://blogs.cfainstitute.org/investor/2020/11/30/responsible-innovation-in-distribution-three-channels-for-asset-managers/#comment-733965)

   Thanks for sharing how a retail investor really needs advisors and intermediated distribution. That sounds like a great way to really help them out. Then they are less likely to make a mistake.

   Reply (https://blogs.cfainstitute.org/investor/2020/11/30/responsible-innovation-in-distribution-three-channels-for-asset-managers/?replytocom=733965#respond)

2. — **T. Neil Bathon (http://www.fuse-research.com) says:**

   26 November 2021 at 14:03 (https://blogs.cfainstitute.org/investor/2020/11/30/responsible-innovation-in-distribution-three-channels-for-asset-managers/#comment-833954)

   Reflects an outdated, if ever relevant, mindset about distribution that simply does not apply to the U.S. marketplace.

   Reply (https://blogs.cfainstitute.org/investor/2020/11/30/responsible-innovation-in-distribution-three-channels-for-asset-managers/?replytocom=833954#respond)

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