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Jupiter Market Comment by Guy de Blonay, Fund Manager, Jupiter Global Financials Fund

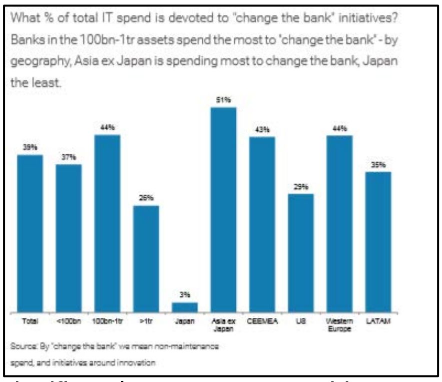
Financial Innovation: US banks steal a lead on European, Asian peers

In recent years, technological developments, new regulations and the rise of digital savvy millennials have combined to form an irreversible trend towards innovation in the global financial sector. While banks remain best placed to dominate the industry in the future, they need to keep up with the fast-paced digital revolution if they are to withstand disruption. US banks are leading the way, but European and Asian banks have been slower at increasing their IT spending to meet the challenges of the fintech age.

Technology is at the heart of the structural changes occurring in the global financial sector. Banks have already drastically changed the way they deliver products and services. After all, they must meet customers' ever-changing needs. However, lower barriers to entry mean that a flood of new financial technology companies is entering the market. They offer a wide range of innovative products and services and pose a serious threat to banks.

With established customer bases, licences and brands, traditional banks should be best positioned to dominate the industry in the future. Nevertheless, their complex structure means they must allocate huge amounts of capital to IT legacy systems and maintenance, often limiting available budget for innovation. In fact, partly due to their legacy-free IT, financial technology companies can now offer services up to 50% cheaper than banks.[1] With such fierce competition, banks must therefore take the lead in developing and adopting new technology if they are to stand any chance of defending or growing their market share.

US banks are leading the way



While banks globally are allocating increasing capital to technology and innovation, on average they spend only 10% of their revenues, and 15% of their total costs, on IT. Furthermore, just 36% of total IT spending is devoted to front office and initiatives that will change the bank. The rest is spent on back office and regulatory or compliance requirements.[2]

Banks' technology spending and will significantly across geographies. According to Morgan Stanley's research, t generally been the most willing to adopt new technology, with US large cap JPMorgan, for example, has grown its tech budget from $9.5bn in 2017 to $ $5bn of this year's budget will be
spent on new technological developments.[3] In part, US banks have been su

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In 2001, Guy joined New Star (which was subsequently taken over by Henderson) where he managed global financial equities. He returned to Jupiter in January 2010, initially in an advisory capacity, before again assuming fund management responsibilities in June 2010.

About Jupiter
The listed British investment manager with boutique-like investment approach, located in London and founded in 1985, employs more than 400 employees worldwide (thereof about 35 fund managers). Today Jupiter is one of the UK's most respected asset management groups. „The Jupiter Global Fund SICAV" (a Luxembourg based UCITS structure) provides clients outside the UK access to the diverse investment capabilities through its 22 sub funds which are registered for distribution in several European countries. Jupiter's total AUMs are GBP 47.7 bn as of 30 September 2018.

with regulators generally treating fintech companies in the same way as established financial institutions. This enables banks to compete on an equal playing field and therefore potentially keep up with the pace of the sector's digital transformation.

In contrast, the European banking sector appears to be most at risk of disruption (with Nordics being the exception). Due to the burden of years of negative interest rates, European banks have generally underinvested in technology, as low rates have eaten into their profit margins. Unlike in the US, regulators across Europe have generally been more welcoming to new financial technology entrants, meaning that the continent's banks have struggled to keep up with the pace of innovation. For example, the PSD2 EU directive enables bank customers to use third-party providers to manage their finances, opening the door to fintech companies wanting to offer financial services solutions.

Asian banks have some of the lowest overall IT spending globally (as a percentage of revenues and costs). However, Asia (excluding Japan) is now spending the most on innovative technology as a proportion of overall IT spend (i.e. non-maintenance IT). Over the longer run, this investment in innovation could have a significant impact: according to the Monetary Authority of Singapore, banks could cut their costs by as much as 30% if they leverage fintech in areas such as automation of banking functions and artificial intelligence, representing 10% to 20% of Asian banks' operating income.[4]

Despite posing some threat to traditional financial services companies, fintech companies can also bring many growth opportunities to the banking sector. Banks are increasingly looking to adopt the services of fintech through partnerships, investments or incubators, with only 7% preferring to develop all technological solutions internally.[5] With a record $58bn invested over 875 fintech deals in the first half of 2018[6], banks know they must embrace change and evolve their businesses or else face significant disruption from new entrants.

Investing in innovation

Innovation in the financial sector has opened new opportunities for investors. These broadly fall into two camps: the technology 'adopters' among the sector's established banks and financial firms, and fintech firms or 'enablers' of financial innovation, which provide a wide range of services and solutions across the financial technology spectrum. The services being offered are vast: From data analytics to security and mobile payments. This means that fintech companies can sell to banks from a variety of different angles, and most have the potential for significant growth. If banks are willing to keep up with the fast-paced innovation, these fintech companies could be enormously beneficial to the traditional banking sector.

Sources:

(1) Morgan Stanley, „A Call to Arms", September 2018
(2) Morgan Stanley, „A Call to Arms", September 2018
(3) https://news.efinancialcareers.com/uk-en/312201/j-p-morgan-jobs-cib
(4) http://www.mas.gov.sg/~/media/resource/publications/fsr/FSR%202017.pdf
(5) Morgan Stanley, „A Call to Arms", September 2018
(6) https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2018/07/h1-2018-pulse-of-fintech.pdf