Disruption in Financial Services
A Bridge over Troubled Water

Solving for issues that really matter
What got this started
What got this started

The Christiansen / Economist Debate

What constitutes “disruption”?
What got this started

...the financial services industry is [not] remotely paying enough attention [...] to necessary disruptions if the industry is to play a meaningful role in SA’s future growth and financial stability.

To truly disrupt the South African financial services industry such that it not only opens the market up to millions of South Africans, but meaningfully addresses their needs and “pain points”... we would need to go significantly beyond the “surface fine-tuning” provided by robo-advice, passive investment strategies, or the addition of new asset classes.
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<th><strong>Let’s test this:</strong></th>
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<td><strong>robo-advice?</strong></td>
<td>As currently envisaged mainly addresses the needs of those with assets, and some measure of technical fluency, and financial literacy</td>
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<td><strong>Passive investment strategies? Smart beta</strong></td>
<td>Lowers costs but doesn’t dramatically change outcomes for individuals</td>
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<td><strong>or the addition of new asset classes.</strong></td>
<td>Provides a measure of diversification but doesn’t dramatically change outcomes</td>
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Minimal impact over long term of lowering costs through passive strategies
Slightly better outcomes by increasing returns (alternative asset classes) – but unlikely to achieve this over long term – not life changing or disruptive!
Dramatically improvements only come if we can change behaviours of individuals.
Asset managers have been achieving 10% real return plus over the last 15 years.

Members have been retiring from funds with a third of their RR targets.

Changing outcomes for members is a function of changing member behaviours and employer conventions around salaries.
The retirement fund industry is a failed savings model for creating financial stability in South Africa.

We need to solve for the journey not just the end goal to keep people from cashing out on these critical savings.

Getting financial stability for members is probably the more relevant problem for employers than solving for retirement.
Why retirement savings is ripe for disruption

While compulsory savings are essential, perhaps saving for retirement shouldn’t be the primary focus in South Africa.
What is it that South Africans require most?

- SA has a different demographic pyramid from the US, Europe & northern Asia
- SA’s problem isn’t retirement – it’s about social mobility for its’ youth
- But this is problem our industry places it’s greatest emphasis on
- That said: savings are critical to fueling economic development
What are the “pain points” / needs of South Africans?

- Social mobility not just social security
- Debt and the challenge of providing families with day-to-day needs?
- Financial capability / financial gullibility
- Managing the financial trade-off decisions of life – what are the long term implications to the family?

How many of our sophisticated 1st world financial solutions actually address these issues?

This is about the top 1%....or the bottom poorest. It’s about the vast swathe of South Africans that represent the invisible middle.
Research question

"I would be interested in committing to a long-term savings programme if I could also use it to: "

- cover family funeral costs
- get a lump sum at retirement
- get access to emergency funds
- buy or build a house
- pay for education
- pay for medical expenses
- protect family from loss of income
- get a monthly income in retirement
Here are the points of vulnerability:

- What if individuals realise that this is their money – and demand their rights?

- What if individuals realise they don’t need you to achieve their needs
  - Is there any value to financial advisers?
  - Are asset managers necessary?
  - Do we need insurers?
  - Could all of this not be done algorithmically?
Building the disruptive savings model for SA
Here’s what needs to happen:

- Making savings matter
- Provide an investment framework that can solve for the cycle of lifetime funding needs
- Help individuals understand the long term implications of choices and trade-offs
- Change the engagement and education model to develop financial capability
- Make it easy to address the needs that matter most
The Singapore Central Provident Fund – An Exciting Model

- Government fund since 1965 – Made policy decision on independence that Singapore would not become a welfare state.

- Asset-based development strategy as the key to self-determination and financial capability development: housing the top priority

- Minimum sum calculation at 55 years dictates what must be set aside for annuitisation

- Above and beyond this minimum sum, employee decides on priorities of what to save for
Does it only have to be about retirement?

The Singapore Central Provident Fund

- Employer contribution 20%
- Employee contribution 20%
- Central Provident Fund 40%
- Ordinary 30%
- Medisave 4%
- Special 6%
- Housing
- Education
- Approved investments
- Retirement savings & top ups
- Hospital costs
- Old age
- Contingencies
The Singapore Central Provident Fund – An Exciting Model

• Compulsory savings for all employees – one central fund

• Both employer and employee contribute 20% = 40%

• Recognises family considerations are an important part of the equation

• Understands that there is a lifecycle for savings where saving imperatives change over time – savings need to help people when they it most
Could a similar model work for South Africa?

• This does not need to be a government initiative

• We can convert institutional funds into guided financial planning framework for all South Africans for all seasons

• Put control back to the individual – but provide the critical guardrails

• As a fintech solution this could have a broad reach and at minimal cost.
What would this new framework require?

1. Knowing which aspects of investing are important to meeting a range of different funding needs ......and which aren’t important

   • What most robo-advisers are creating in this space isn’t tackling the problem of meeting specific funding requirements over specific time frames.

   • Robo-advisers aren’t tackling the problem of how to optimally prioritise or trade-off saving requirements.

   • These are complex modelling requirements but they address real needs.

   • Risk profiling, optimisation in risk/return space, and manager selection are all exercises that add nothing to these demands.
When individuals try to solve for these goals on their own = requires 80% of income

In an integrated lifecycle savings solution = requirement reduces to 43% of income

Investment strategies need only be low cost passive - The value is from the optimal redeployment of funds to different strategies over time. Algorithmically driven to address individual needs as and when
What would this new framework require?

2. Changing our engagement and education framework

Financial education is failing

- Interventions to improve financial literacy show a mere 0.1% change in financial behaviours

2. Changing our engagement and education framework

Key concepts for engaging:

1. Teachable Moments
2. Just-in-time Education
3. Understanding Bandwidth
4. Rules of Thumb
5. Defaults
6. Smart Defaults
7. Translate Future into Present
8. Understanding Trade-offs
9. The Right Incentives
What would this new framework require?

2. Changing our engagement and education framework

What stage of receptiveness?

What preconditions shape your ability to engage?

Meet Socos MuseBot

“...When Kahlen is frustrated, remind her of a time she overcame an obstacle in the past.”

Automatic thinking vs deliberative thinking
The role of social context
Mental models
Relationships with and mindsets on money

What AI can teach us about how you best learn
What would this new framework require?

2. Changing our engagement and education framework

How are you genetically pre-disposed to saving?

WHAT MAKES A GOOD SAVER?

Is saving something that belongs to the realm of nature, or nurture? Will individuals who are innately inclined to save become economically successful, or can individuals achieve economic mobility simply by adopting good habits around saving and money management skills?

Findings from joint Swedish and American research on identical twins suggest that individuals are indeed born with a propensity to a specific saving behaviour. Genetic differences can account for around 33% of the variation. This genetic influence, according to the study, seems to persist throughout an individual’s life. But socio-economic circumstances and parenting influences can interact to temper that genetic predisposition. That said, parenting influences (good or bad) tend to dissipate when the individual becomes an adult. In the long run, current socio-economic circumstances trump upbringing, meaning that we can potentially nurture a savings habit.

A further insight from the same study is that “behaviours regarding savings appear to be genetically correlated with one’s predispositions towards self-control or time preferences” – in other words, one’s level of tolerance for delayed gratification. You may be familiar with the famous marshmallow test conducted at Stanford University in the 1960s, where Walter Mischel made a direct connection between a child’s willingness to postpone eating a marshmallow in order to gain an extra one and their professional success later on in life.

Perhaps the more intriguing aspect of the Swedish-American study is their finding that, while there appears to be no correlation between savings and education, there does appear to be a significantly positive correlation between an individual’s savings rate and income growth. Slightly more disturbing, though, was their observation that there also appears to be significant negative correlations between obesity or smoking and savings.

Now, none of this suggests that social dynamics are not an important factor. What the research doesn’t tell us is how life experiences might factor in here. Nor does it give us any insight into when genetic predisposition might be the dominant influence or when environment might be the dominant factor. What we can conclude though is still important. Any number of factors are at play when it comes to an
### 3. Changing what we teach:

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<th>How to avoid scams or unrealistic expectations:</th>
<th>Understanding probabilities may be more important than compounding</th>
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<td>How to know what you don’t need:</td>
<td>The simple questions to ask to determine is you need insurance</td>
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<td>Understanding product pricing trade-offs</td>
<td>Making the trade-offs transparent through modelling</td>
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<tr>
<td>Embedding the “how-to” inside of the product itself</td>
<td>Knowing how to get from “A” to “B”, not just how much you need to get there</td>
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We believe this …

- is better than the current set up, & doesn’t rely on government
- would engage more people
- would go some way to addressing the more immediate needs of the people – one of the impediments to reforms aimed at longer term savings

- Would represent real disruption
Closing comments

Are you ready for the challenge?