Discussion of "FinTech Platforms and Mutual Fund Distribution"

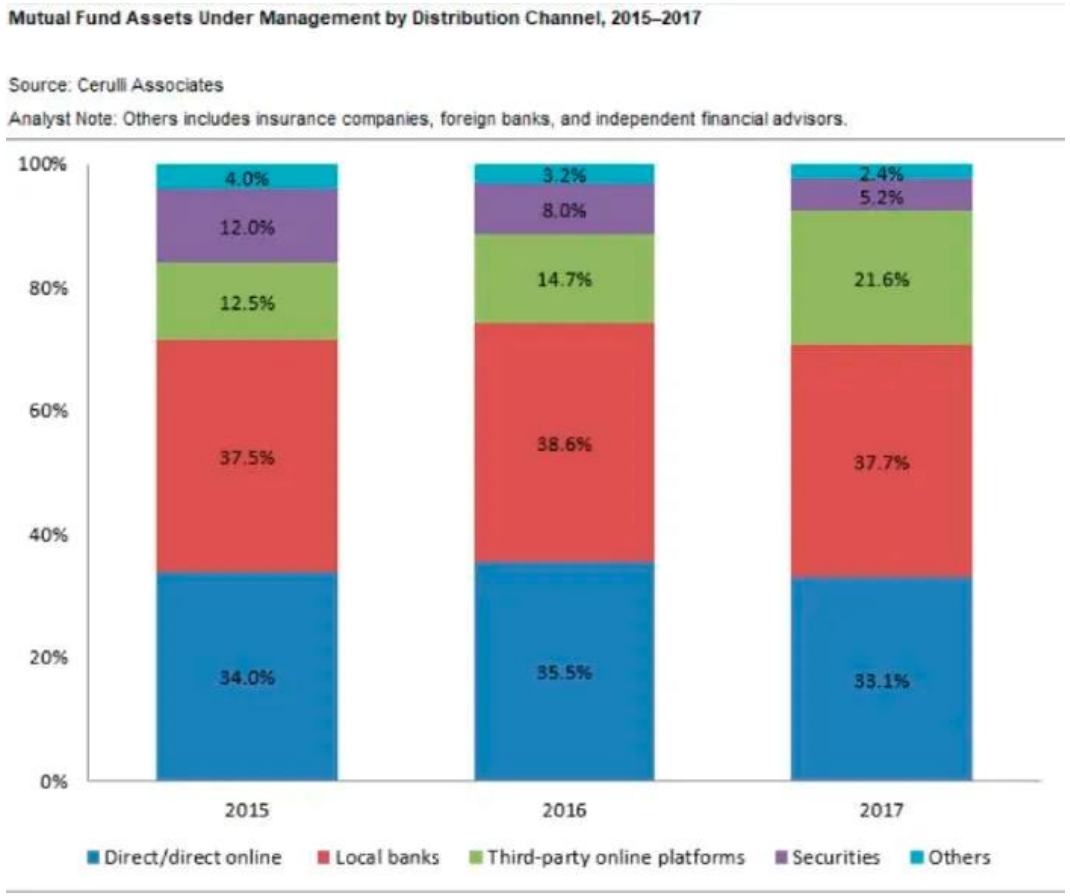
Ben Charoenwong

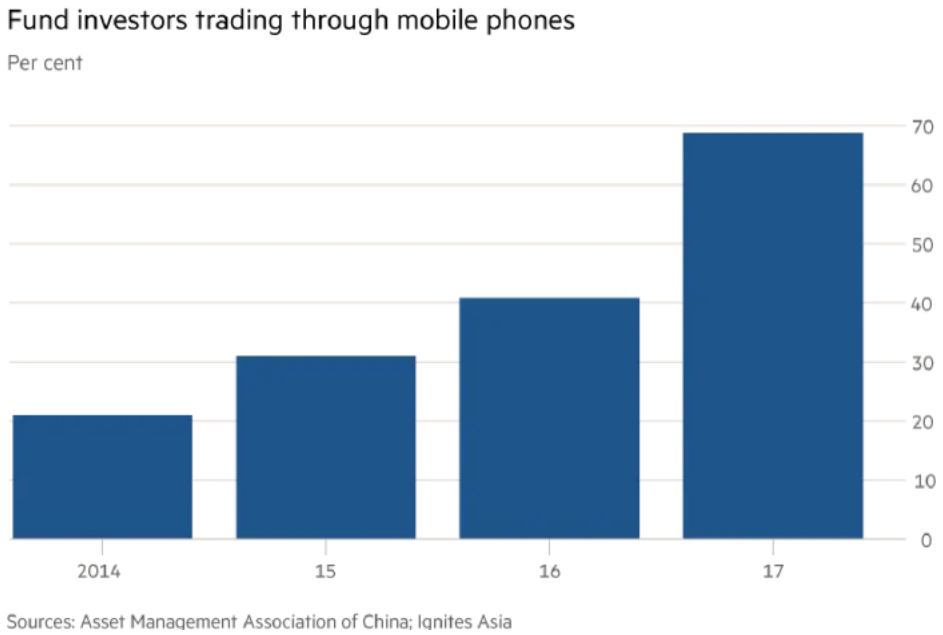
NUS Business School

Overview

- Objective: study the impact of fintech platforms on investors' allocation of risk and fund managers and fund families
- Paper studies differential responses of aggregate fund-quarter level flows comparing funds not on platforms and those on platforms.
- Aggregate Flow-Performance Sensitivity Results:
  - In 2013 through 2017, flow performance sensitivity increases dramatically compared to 2008 to 2012.
  - Top decile flow also increases from 1.88% to 19.7%
- Distributional across fund results:
  - Share of AUM in top families decreases
  - Share of top decile funds from top fund families also decreases
- Fund-level risk-taking results:
  - Take about 7% (10.9 basis points) more risk
- Many "hot" topics: fintech, platform, performance-chasing. A lot of interesting facts. Also a lot of robustness tests (results not due to funds timing their entry, aggregate market conditions/investor sentiment, etc.)
- "limited empirical evidence with respect to what actually happens when platforms take hold of a sizable market share in the distribution of financial products"
  - Paper has important implications for policymakers and academics when thinking about the IO of financial services and potentially asset prices.

Banks appear to still dominate mutual fund AUM by distribution channel, but many people trade on phones.





Source: https://www.ft.com/content/7f9deba0-51e1-3c8e-9f1c-1d71a384028d

Comment 1. Economic Framework

- Some of my confusion:
  - P. 5 “the first to provide extensive empirical evidence on what actually happens when the tech-driven mobile-device-based platforms are allowed to enter the financial intermediation industry”
    - What is the specific importance of this being mobile versus desktop browser-based?
  - What does “Performance chasing at the individual investor level gets synchronized” mean?
    - Expands the investment universe and so cross sectional comparisons use a larger (and the same) set of funds
- In my mind, there are two potential effects of fintech platform introduction
  1. **Reduction of Trading Costs**

     Subscription fee waivers across platforms. “As of 2019, both Tiantian and Ant Financial waive 90% of subscription fees for all funds offered on their platforms.”
  2. **Reduction of Search Costs**

     Coverage of many funds and “centralized information structure”

Comment 1. Economic Framework

- Similar but distinct theoretical implications.
  - If reduction of trading costs: can amplify existing behavioral biases but also increase within-person participation
    - Each retail client can invest in more mutual funds
  - If reduction of search costs: investors tend to make better asset allocation choices due to access to more information.
    - The more funds on the platform, “the better” allocations (cross section and time series.) Suggested test: Flow-performance sensitivity*log(# of funds in a given point of time).
  - Paper focuses on a reduction in search costs.
- Note: Even if trader composition doesn’t change (section 4.2), trading behavior changes if search costs are lower.
- Challenge: These mechanisms interact with each other and are confounded by the 2012 policy shock.

Comment 2. Variation in the data

- **Sample Characteristics:** Winsor flowed at 2% level. A little high? Minimum fund size of RMB 1 million (< 150k USD). This still admits really tiny funds. What quantile of size across all publicly available funds is this?
  - Is there a correlation of fund size and return volatility? (small funds may be able to take more risk).
  - Are smaller funds more likely to show up in either extremes? Can you speak to implications of fund growth (also related to fund-size & performance relation).
- What is the goal of the empirical analysis?
  - Estimating **treatment effect on the treated** or **intent to treat**
    (i.e. effect of policy change directly, letting funds, investors, and platforms endogenously react)?
  - If the former, authors should consider the selection process for both investors and funds onto the platform, and also how the CSRC grants licenses.
  - Are there any potential differences in fees charged by investments through the platform vs. through other channels that you can see based on share class data?
    (In other countries this can be done through different share classes of the fund.)
  - Estimates of **treatment effect on "compliers"** does not necessarily tell us about **treatment effect on the treated** (staggered fund entrance)
- 2012 Policy Change: Worth discussing more how the licensing is done, how long it takes, number of applications right after law change, etc.
  - Any other law changes?

Comment 3. Implications of findings

- Performance Chasing Could be “Value-Increasing”
  - Extrapolative expectations or learning?
  - How persistent are mutual fund returns in China?
    - Carhart (1997) shows some mutual fund across-year momentum. Choi and Zhao (2020 NBER Working Paper) shows that has deteriorated in the later sample (through 2018) due to lower returns to favorable styles (potential crowding).
    - Gao, O’Sullivan, Sherman (2017 Research in International Business and Finance) & Cornell, Hsu, Kiefer, Wool (2020 Journal of Portfolio Management) find historical performance predicts future performance
      - “When an equity mutual fund is in the top 1% of their ranking in a particular 6-month period, the probability the fund will be among the top 10% in return in the following period is 22%.”
    - But some contradicting work as well.
  - But if flow is high and funds have diminishing returns to size, can reduce the persistence but make the market more efficient.
- “FinTech platforms can considerably lower the barrier to financial market participation” (p.5)
  - Puzzle: Authors do not find that reduced participation costs induced more entry into the mutual fund industry as a whole.

Overall

- High potential paper which is useful for many markets around the world, with an impact on policymakers, academics, and financial services industry
- Looking forward to a restructured paper