[SQUEAKING]

[RUSTLING]

[CLICKING]

GARY GENSLER: Today we're going to dive into a topic that is relevant to all of us right now, is the coronavirus crisis.

And for those watching in the future these recordings, we'll see how many of these predictions might come true.

But we're going to try to sort of frame fintech in this crisis.

And it's both a health care crisis and an economic crisis.

I thought that I would spend a little bit of time in this class talking about some financial crises in the past.

I'll talk about the 2008 crisis more specifically.

We'll take a look at some of the economic forecasts here in May of 2020.

And of course those looking in the future will sort of look back and say, aha, was it better or was it worse?

I have some points of view about that, and I'll share those openly.

And then we'll sort of finalize about what this means for fintech and some of the sectors and subsectors within the space.

So with that, I am going to try to share some slides and get going.

So that's the overview of what we're going to try to do.

And looking a little bit at crises, the '08 crisis, as I said, grounded in what's happening today.

I'm glad to take questions at any point in time.

This is a little bit more relevant today, but it's also much broader than just fintech.

Some of the readings were around what's happening in financial technology, the interviews that TechCrunch put out of eight top fintech VCs and what they were saying.

I will also close this discussion with something that Boston Consulting Group just put out in May of 2020.

So just a few questions to get going and see if Romain has a little fun with calling on folks.

But how's the coronavirus crisis affecting the financial services world more broadly?

Not fintech, but the financial services world more broadly.

And though it wasn't in the readings, many of you are studying finance and are from the world of finance.

So these could be just your personal opinions, of course.

TEACHING ASSISTANT: Good morning, everyone.

Come on, this is one of your last opportunities to shine.

Olivia, you have the floor.

AUDIENCE: So with the stock market sort of tanking in the past few months, that would impact any business that manages financial assets.

So mutual funds, hedge funds, the like, the vast majority of them probably have their asset base declining in a similar way.

They're all working remote as well.

So you could think of ways that might impact other financial services companies that maybe are not quite as technologically savvy as other sectors.

But basically any business-- it could be insurance.

It could be banking-- will have to revalue the assets that they hold on their balance sheets.

GARY GENSLER: So can I pause just for a second because you mentioned about four or five really important things.

One is the volatility and that financial services really stands, in our economies, as managing and helping the economy more broadly manage risk.

Taking in risk and transferring that risk and pricing risk.

But the volatility itself has come along.

Now, some firms will fail.

Some firms won't.

When I was at Goldman Sachs, there was a saying-- I didn't create the saying-- is that volatility was our friend.

Well, it was our friend if we could manage it well, not if we stumbled along the way.

But financial firms are often in the business of managing risk, whether they're insurance companies, investment banks, and the like.

So that's one thing that Olivia has mentioned.

But she's also mentioned assets.

And in two different ways, I just want to highlight.

Assets under management for the wealth management or asset management field has shrunk a bit.

And so to the extent that BlackRock used to be maybe $7 trillion of assets and maybe it's $6 trillion or $6 going to $5, that's fewer assets under management.

But also I think the second piece that Olivia mentioned is really critical, is valuing those assets, particularly, let's say you were in a commercial banking field, or you were in a fintech field making loans.

The actual loan side of the balance sheet, you're seeing that commercial bank after commercial bank is taking losses on those loans in anticipation of the delinquencies and defaults that will come.

So that's a revaluation of their loan portfolio, and is likely to continue.

I think I saw Danielle's hand up as well maybe in there.

TEACHING ASSISTANT: Yes, and then Adam.

AUDIENCE: Yeah, I was going to say one of the other trends is a change in the pace of investment into fintech firms.

That's probably similar to what we're seeing across the investing portfolio, but people are struggling with finding places to invest with the new remote operations, as well as fintech firms pivoting and looking more internally.

And within the venture capital space, there's been some reports of investors advising startups just to focus more on their core business operations, scale back auxiliary functions, and generally have a return to core business.

GARY GENSLER: So let's just take those two.

And we're going to dive all the way into all of these, but one is basically that the funding, the funding coming in to fintech and the venture capital firms to themselves, these two married points, are really looking at things differently.

That the companies need to look at their operations and look at core operations.

And we'll talk a lot about that, whether it's in fintech or more broadly in the economy, that companies that were being funded by the venture capital field generally are not yet cash flow positive.

Some are, when they're at series C or D or even E rounds.

But certainly early in their lives, they generally are cash flow negative.

And so how much runway they have, how much time they have, in essence, to turn the corner to get cash flow positive and profitable.

And of course the venture field itself is being more cautious, and so funding is slowing now.

You said Adam was also one of-- TEACHING ASSISTANT: Yep, Adam.

AUDIENCE: Hey, good morning.

So my point, not necessarily related closely to fintech, but certainly an important trend in financial services.

So I'm into commodities, and I'm working on a paper with Professor Mirkin regarding oil prices.

GARY GENSLER: Adam, do you mind turning on your video so we're with you?

AUDIENCE: The thing is I won't be able to see you then.

That's why-- GARY GENSLER: Oh, all right, so let's keep going.

AUDIENCE: So since you can't just stop producing oil, like most of the valves in the US and across the globe, the way it's structured, it's not a switch that you can shut off.

And I'm sure all of you know we don't drive as much now, and we don't go outside.

Airlines obviously don't operate with the same capacity they did before, so we don't use oil.

But on the other end, we still produce almost the same amount of oil than before.

Oil prices took a major, major hit, forcing a lot of valves to shut down, probably for good, just because it's not necessarily possible to reopen smaller valves.

And I think the whole energy sector, if this goes on for a bit longer, might be completely-- the way it was before coronavirus, it will be completely new after.

Because a lot of players were forced out.

The US's place as the biggest oil exporter might change.

GARY GENSLER: So can we circle that back to financial services?

What you're saying is the commodity field, the commodity sector is taking quite a hit.

There's a demand shock.

It's been one of the most serious demand shocks that we've seen in several decades, one might even say in a hundred years, on energy and on many other physical commodities in the energy and in the metals space, less so in agriculture.

And so that demand shock has led to a price shock.

We've also had a bit of a scuffle between Russia and Saudi Arabia in terms of oil production and the like.

And so how does that circle back to the financial services field, in your mind, Adam?

Sort of a brief-- AUDIENCE: I follow, as you know others look into the fields that they are interested in, follow a lot of funds, hedge funds, specialized funds in energy, commodities space.

And a lot of these players took major hits.

GARY GENSLER: All right, so what's your-- AUDIENCE: And some of the biggest companies in energy is Zimmer Partners, with like a 25-year track preferred of over 20% average return annually, so pretty impressive firm.

[INAUDIBLE] reported a 55% loss in the first quarter.

And they are among the most renowned funds in the sector.

GARY GENSLER: So if I can bring it-- Adam, can I just bring it short?

Because we don't have a lot of time.

Let me just shorten it up.

What you're saying is there's a commodity price shock.

It's moving into a demand shock, a price shock, and it's moving into financial services with returns for the asset managers and hedge funds in the commodity space.

Did I capture it?

AUDIENCE: Yeah, absolutely.

GARY GENSLER: Thank you.

So we've talked a little bit about how it's also hitting towards fintech itself.

Some of the funding side, we're going to go into that more.

But what about the positive trends?

Are there any positive trends likely to emerge out of this for financial technology firms?

TEACHING ASSISTANT: Ivy, would you like to give it a shot?

AUDIENCE: Yeah, sure.

So I think there's definitely going to be winners and losers from here.

So previously, as we know, there's been a huge emergence in terms of fintech across all these spaces.

And a lot of them are not profitable.

And so I think the positive trend is that firms with, I think, disciplined underwriting as well as actually a working business model will emerge from this unscathed-- not unscathed, but probably gaining more market share and doubling down.

So I actually think that's a positive, I think, for just the general market because it is a little oversaturated.

GARY GENSLER: So Ivy's highlighted it's a highly saturated field.

But for those who have a truly viable business model, that may play to their advantage.

We're also going to talk about various sectors that might play to their advantage as well.

And I think there is another hand up.

TEACHING ASSISTANT: Hassan?

AUDIENCE: Yeah, so, for instance, I can talk about my country, Bahrain.

With this pandemic, I've noticed that people who are not used to fintech technologies have not gotten used to it, and they're taking advantage of these kind of services.

So I think that even after this pandemic is over, behavior has changed forever.

So this is my take on it.

GARY GENSLER: Yeah.

So it accentuates trends.

We've already been over the last three-ish, four decades digitizing the economies, but not uniformly around the globe.

And so this accentuates that trend to digitization, and it accentuates a trend towards online commerce.

And in both of those trends, they were happening already.

But I think Hassan's raised a really important point.

It accelerates some of those trends.

And those will create opportunities and challenges, and there will be winners and losers, as we talked about.

So I'm going to sort of dive in.

Financial sector crises are not new.

This is just sort of a sampling of a list.

And even in 2008, we were followed by European debt crisis in 2009 and 2012.

And so the question will be is not just this crisis, 2020.

Is it to '21?

Is it to 2022?

Does it have aftershocks beyond that?

I'm here to say it's not just the 2020 crisis.

But I think you all knew that already.

But I'm also going to say that finance, by its very nature, tends to have crises every five, 10, 15 years.

And each time, people will have some conversation about this is the worst crisis in 50 or 100 years.

So it seems like we get the once-in-a-50-year crisis every 5 to 15 years.

And in your careers, you will probably see five or six more.

Now, God willing, they won't be driven by a pandemic, and there won't be millions of people or hundreds of millions of people put out of work through a lockdown to protect ourselves against a virus.

But you will see other financial crises along the way.

I have.

I didn't work in the 1970s, but from the 1980s on.

And some were more severe than others, of course.

The financial crisis in '08-- just to remind you.

We're not going to dive in deeply-- weak underwriting, a lot of easy credit, poor risk management, and then multiple failures around.

This is what was called systemic risk.

Emanating first out of the US and the housing markets, and the housing markets had an asset bubble.

But it was also true in Spain.

It was also true in other European countries.

It was not only isolated to the US.

But in a financial sense-- not in a health care sense, but in a financial sense-- we Americans and a couple other markets like Spain and elsewhere sort of propagated out to other markets a contagion, if you wish, a financial contagion to the rest of the world.

Now, some countries like China, Australia, Canada sort of weathered the financial storm well, but they were still hit with an economic shock.

You couldn't avoid it, in a sense, because we're so interconnected economically around the globe.

And what was the result after that crisis, just for a moment?

There was financial reform.

Around the globe, primarily in Europe, Canada, Australia, the US, Japan had to put in place a stronger set of regulations.

It didn't change the fundamental basic regulatory environment, but more capital, more shock absorbers within the banking sector, more transparency in the derivatives markets, and the like.

TEACHING ASSISTANT: Gary, I think I recognize you on this picture, no?

GARY GENSLER: All right, so where?

Where, Romain?]

TEACHING ASSISTANT: In the front row?

GARY GENSLER: Oh, you mean the center, bald head?

No, it's just a little light hearted.

We could have done a poll and asked how many people think that's me?

But I'm sorry to let you down.

That's Ben Bernanke, the chairman of the Federal Reserve.

I think I am in the bottom right-hand corner.

So I think I'm sort of not in the front row with the chairman of the Federal Reserve.

I think I was in about the third row, as my memory serves me.

But thank you.

For those who don't-- I was honored to be chair of the Commodity Futures Trading Commission at the time.

That set of reforms-- that set of reforms, I give you here a four-year-old chart out of a law firm, Davis Polk, that kept track of these things.

But those Dodd-Frank reforms were around transparency in the derivatives markets, asset-backed securitizations, the sort of resiliency of banking itself, and a lot about consumer protection, mortgage market reforms, and the like, and systemic risk.

And so this just gives you a sense of all the different slip streams that came out of that reform.

Many people would say that that crisis started in the financial sector.

It's not quite true.

It was the housing sector and asset bubble in the housing sector, easy credit, and certainly the financial sector was at the center of it.

But it's the mix of housing, finance, and frankly a failure in Washington and in London and elsewhere to stay abreast and help regulate the market.

So a failure in the capital markets and in finance, but also a failure in public policy that got behind and loosened relation to finance.

We're living in a different set of crises now, I would say.

Fintech, fertile ground.

We've talked about this for the whole 10 classes we've had.

But in the midst of the corona crisis, I think four of the fertile grounds that we've already talked about are accentuated.

Digitization of money.

We still have paper money.

I think we're going to move even faster on this.

What's an interesting thing in the last seven weeks, the US Federal Reserve has actually continued to issue paper money.

Paper money has grown not significantly, but it's grown close to 4% or 5% in outstanding.

Now, that might be a flight to quality.

It might even be drug runners who want paper money.

Wide acceptance of new tech.

I think that we already were realistically in a mobile phone, mobile delivery user interface.

But I think that's accentuated.

I think we've accentuated these trends about large pools of data and the value of those pools of data.

So what do we see in terms of fintech incumbents and the big tech?

Well, big finance we've talked about.

Huge volumes in the capital markets, government debt markets.

They're working on these stimulus loan programs.

And they've also boosted their allocations of loan loss reserves.

I think we're still six to 18 months away from significant delinquencies.

In the corporate sector and the leveraged loan marketplace, we'll see some of those earlier.

The high-yield debt market, small business loan market, we'll see those in 2020.

I think in the household sector, we'll peak in 2021.

I could be wrong.

And when people are listening to this in the future, they're going to look back and say, boy, he took some risks.

But I'm willing to take some risks where I think there's some challenges.

I think also big finance is very reliant on connectivity.

These trading floors-- if you went into a trading floor in London or New York, you would see hundreds of people on a trading floor.

And now they're dispersed.

And the New York Stock Exchange went to electronic trading.

Will they ever even come back with physical market makers on a floor of a New York Stock Exchange?

Maybe not.

I'll be willing to make that prediction.

But big reliance on connectivity.

Big tech, significant online growth.

And you have different parts of big tech.

You have the ones that are really focused on data and analytics, like Google and Baidu.

They're being called more into the fray to use that data to help protect the public through something called contact tracing and the like.

You have the online market shops like Alibaba and Amazon, huge growth, of course.

So significant online growth.

And then we go to the fintech startups.

And I'd say the real focus on the fintech startups is this number one point, what's your runway?

A term that we haven't talked about in this class, but runway is what's your burn rate?

See, early startups-- not just in financial technology-- early startups usually are spending more than their revenues.

And they're trying to work to that sweet spot when they can get to a place and be really successful, where, of course, revenues are more than costs, but also they've built a platform.

They've built and start to commercialize the network economics.

And by network economics or platform economics, it's bringing two sides of a marketplace together and building a platform in between it.

But there's a big focus on revenue models and adoption.

And if you've recently raised money, you're in better shape then if you haven't.

So it's not about whether you're at the seed round or a series C or D, meaning you've done three or four rounds of funding.

It's really, how much cash do you have?

What's your burn rate?

And hunkering down.

IPOs, Initial Public Offerings, probably off the table for the rest of 2020, and maybe well into '21.

Venture capitalists will talk, as you saw in these readings, that they are investing, but they're going to be slow and cautious.

And valuations, just like the public market's down.

But if you don't have an IPO takeout, if you can't exit in the public markets, if you can't readily convince your venture capitalists about your revenue models, your valuations are coming off.

I think consolidation increases.

I think that the sectors matter, and there's going to be winners versus losers.

I think anybody that's deeply reliant on transaction fees, particularly in the payment space, that's a challenge right now.

Some businesses, the sector matters even more, like if you were Toast servicing the restaurant field, I have not talked to them since this crisis started, but I think that's a challenging thing.

You could be a transaction-based business and have been in great shape in January and really pretty lousy shape right now.

So some areas like retail, travel, events, obviously.

Mobile trading-- mobile trading, on the other hand, might be up, the Robinhood numbers and others like them.

Wealth management like Betterment that we talked about, maybe.

But if you're like Root Insurance, if you're an auto insurance tech and people aren't driving, it might be the other way.

So sector matters a lot.

Compliance up.

International cross-border remittances, I believe likely has some possibility.

But I still think runway matters and consolidation increases.

And so a couple other thoughts.

Additional opportunities.

I think there's additional opportunities if you're serving those tapping into the fiscal stimulus and loan programs.

So what you've seen around the globe, whether it was PayPal, SoFi, others saying, we will help a small business.

Revolut in Europe, we will help a small business fill out their forms, apply for the programs here in the US, programs in Europe.

And that's an opportunity to actually build customer relations.

Numerous amongst the fintech startups here in the US have raised their hand and said to the Small Business Administration, can we be basically part of the PPP program?

I don't mean receive a forgivable loan.

I mean help issue forgivable loans.

Romain I want to pause because I see there is activity in the chat room and just see if there's-- TEACHING ASSISTANT: So we have a general question from Rosanna on whether there is a chance that this crisis will impact the stability of the US dollar.

GARY GENSLER: I think, great question.

When you say stability, I think of volatility.

But Rosanna, do you mean that, or do you mean its centrality in the world trading system?

AUDIENCE: I think centrality in the world trade system.

GARY GENSLER: OK.

So I think that crises like this usually-- and history shows this time and again-- it's flight to quality.

And so right now, the US dollar is that quality asset.

Our economy has got huge challenges.

But I'm saying as a fiat currency compared to other fiat currencies, I think you've still seen the flight to quality in the US dollar.

I do think that if you go out multiple decades, our handling, as a public policy matter, people will be looking, how did our government respond?

How did we respond to the health care crisis?

And I don't mean in the middle-- right now, there's going to be all those debates and they'll influence all sorts of things like the November election.

I'm talking about longer term.

Longer term, how did we as a society, how did we as a government handle this crisis?

And I think this story is not written yet, even though right now there's a lot of reasons to think we didn't handle things well in January and February and March.

But we don't know about the reopening yet.

But the US dollar, which is probably over half-- depending upon what statistic you want to pick, between half and 2/3 of trade, the foreign currency markets, the central bank reserves around the globe are on the US dollar.

I think you raise a great question.

Will it change the US dollar as the world's sort of leading currency?

My guess is, probably not.

I think we're still multiple decades away.

I think if China wants to take that role at some point in time, probably late in the 21st century sometime, they have to really adjust themselves to having a more open capital market.

The US took the role from the British just about the same time as the last big pandemic, the one a hundred years ago, the Spanish flu.

It's a coincidence, maybe, so you're right to raise it.

But I don't think China is in the position.

They don't have free and open capital markets.

The US had free and open capital markets.

They don't, frankly, have the same legal systems that we had.

And so the UK was in relative decline to the US already.

I don't think it was the Spanish flu that gave us the chance to take over.

World War I did give us a chance to take over.

And so you're right, some future crisis might be that moment, but I don't think this is that moment.

That's a good question.

AUDIENCE: Thank you.

What about the volatility, though?

Do you think also that's-- GARY GENSLER: I've got three minutes to finish up, so can we do this offline?

But there's also additional challenges on delinquencies and defaults.

I think for fintech companies, they have to be very aware, especially if you're in consumer or small business lending, that delinquencies and defaults will go up.

I just think-- and if you have a business model related to float because interest rates went down.

So this is where I'm going to close is this chart from the Boston Consulting Group breaks subsectors.

And again, in this class, I constantly am focused on granularity.

You can be strategic, but you have to be tactical.

You've got to get down to each sector.

In payments, trade finance is probably at high risk.

But other areas might be OK.

Account to account, person to a person like Venmo, Paypal's Venmo, might be in a good place.

In lending, unsecured personal lending, Boston Consulting Group says a problem.

But their other parts, like lending on infrastructure, might be OK.

So you've got to get granular.

You've got to think about each sector individually.

Insurance, I also think it will be interesting to see what happens to some of the auto insurers that BCG hasn't put on this chart.

Everybody's going to have their different chart.

This is not to say this is the accurate chart.

I raised this Boston Consulting Group chart because I want to always remind, it's granularity.

You need both strategy and tactics and to get into where the cracks are in the system.