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Why Fintech Needs 'Guardrails'

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The ethos of fintech is in large part tightly connected with the notion of financial inclusivity or democratization of finance. Simply put, the mission is to provide easy and readily accessible financial services in the hands of everyone and anyone. One can build a compelling and appealing case around the democratization of financial services. Through innovation and disrupting technologies, financial services can not only be digitized but transformed into achieving financial inclusivity to which conventional approaches can only aspire. These notions are echoed in the halls of fintech companies, virtual conferences, podcasts, Clubhouse sessions and, more

recently, mainstream news. It is truly an exciting time to be a part of the fintech journey.

Differentiating itself from the Wall Street stereotype, it's not hard to see why some might think this ethos of fintech is new. Interestingly, we have seen shadows of this ethos before. There was a period in our history where it was believed everyone in America should own their own home. To make that possible, financial services were typically needed to finance that purchase. Leading up to the global financial crisis, financial services in the form of mortgages were being handed out like speeding tickets at the Indianapolis 500. What followed was a period of significant regulatory change to establish guardrails across the financial industry.

Investors in fintech firms demand growth: growth in accounts, growth in customers, growth in payment transactions and growth in trading with the intent of commanding a higher multiple. Risk management and compliance are often not on the radar, as investment dollars are directed toward driving growth. Like any car, the fintech company will at some point need brakes in the form of risk management and compliance — usually prompted by aspirations of a banking license or broker-dealer license, a major equity investor demanding it as part of a funding round, or worse, a very big capital call.

When the news of the recent roller-coaster saga of Robinhood, GameStop and the other highly volatile "meme stocks" hit the wires, I couldn't help thinking about "Power Peg" and Knight Capital. While Knight Capital's predicament was the result of dormant code and human error, Robinhood's was the result of social media denizens of Reddit pumping up GameStop's share price to a stratospheric peak of $483 in late January, some using margin and options to achieve double-digit gearing. Robinhood appears so far to have emerged from the crisis better than Knight did, having navigated the capital call with the help of its venture capital investors doubling down, but it has drawn the attention of regulators.

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An unexpected outcome of the global financial crisis was the recognition that compliance was no longer simply a cost of doing business or necessary evil; it had the potential to be a differentiator and a competitive advantage. Financial services is about taking risk or helping others take risk. The stronger one's risk management, the better one can take calculated risks and hopefully earn higher returns. Allow me some latitude with an analogy to better illustrate the point. What component on an Indy or Formula One race car can make the difference in enabling it to get around the track in a controlled manner the fastest? The brakes. With strong brakes, the car can go longer, deeper and faster into the turns. Having strong brakes, like strong risk management, can be a competitive advantage.

A decade and a half later, the fintech crowd must commit the same level of innovation to risk management that it is using to develop consumer applications. It will not only provide individual firms with competitive advantages but strengthen the industry as a whole. And doing so would usher in an era of financial democratization that benefits everyone.

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