LUMOS View

July 23, 2016

Millennials, Trust Scoring and the Future of Financial Services

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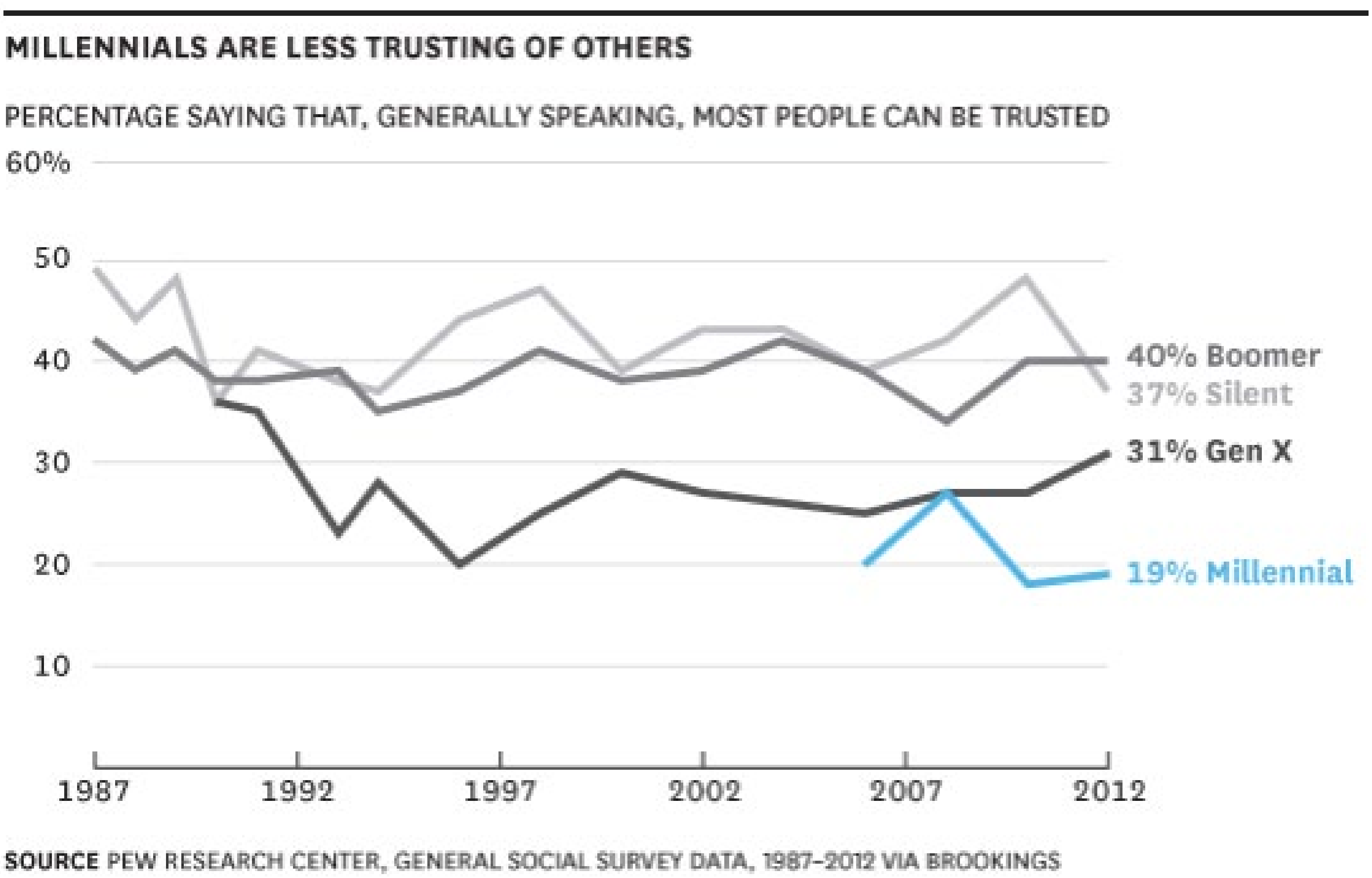
Earlier this year, Millennials officially surpassed Baby Boomers as the largest generation in terms of population size. Generally considered those aged 18 - 34 in 2015 (born between 1981 and 1997), US census data showed that there were 75.4 million Millennials living in the USA last year, surpassing Boomers by more than half a million.

And yet, despite the size of this generation, they lag massively behind in the realm of financial services. There are many reasons for this, which we will explore below, but it primarily comes down to trust. Until Millennials are instilled with trust and confidence in their financial services providers, an entire generation will fail to reach its financial potential. To achieve this outcome requires some radical rethinking of how trust fits into the financial services framework, so let's dig into the problems and try to identify some potential solutions for the biggest generation in history.

Trust, Fintech and The Credit Score

For Millennials, where they spend their money and who they bank with is contingent on trust.



Yet Millennials are less trusting of others than any other generation, and consequently, less trusting of the institutions that dominate the Financial Services industry. The heavily cited Millennial Disruption Index showed that 53% of Millennials (generally those born between 1980 and 1995) "don't think their bank offers anything different than other banks" and 71% "would rather go to the dentist than go to a bank." Furthermore, a study by fintech app Bud showed that only 12% of Millennials use financial advisors. Simply put, the world of financial services is a complex and convoluted mess to Millennials, as they don't know what the services are and they don't trust the brands who provide them anyways.

This explains the global explosion of #fintech. The value of global investment in the fintech ecosystem was estimated at $3 Billion in 2013 and is expected to reach $8 Billion by 2018. Within fintech, however, there are many categories, a mix of incumbents and new startups, and no clear definition as to what a fintech is. And the onramp for many of these services, both new and traditional, remains credit scoring. So not only are the services themselves subject to complete end-to-end disruption but so is the criteria to assess who should be able to access them in the first place.

According to research by NerdWallet:

> "The average millennial credit score is 625, and 28 percent of them are ranked below 579, says NerdWallet, a personal finance website. In the world of credit scores, anything above 660 (out of 850) is considered good." What is wrong with millennial credit scores

Scratching beneath the surface, part of the reason for this appears to be linked to a misunderstanding of what financial services are, rather than behaviors linked to indebtedness:

> "Among the key issues: Some millennials (18-34-year olds) are shunning credit cards completely after hearing so many debt-related horror stories from the financial crisis. Others are applying for the wrong cards and getting rejected." What is wrong with millennial credit scores

The combination of an unnecessarily complex, and needlessly expensive, system created by the banks has caused an entire generation to become either: **a)** disenchanted or **b)** excluded, from the global financial system. For a group that is considered to be "driving the economy," this is a big problem.

Not to say that Millennials aren't using credit. A large study by TransUnion showed that Millennials use 79% of credit available to them. But a lot of this debt load is related to student loans (the study was conducted in America), and a large portion of the credit score is related to loan utilization. So when you compare Millennials to other generations, they have by far the greatest percentage of sub-prime borrowers:

GENERATION	AGE RANGE	% SUBPRIME
Millennial	18-36	43%
Generation X	37-51	33%
Baby boom	52-70	20%
Silent generation	70+	9%
Source: TransUnion		

Part of the problem is the criteria that Credit Score is based on. Things like rent payments, where many Millennials probably have a stellar track record because of being 'Generation Rent,' are not included:

> "Chaplin recommends young renters ask landlords to report rent payments to credit bureaus, adding another type of credit to their reports. Not all scores use rental information, but some do, including VantageScores." 43% of Millennials Have Bad Credit, TransUnion Says

When you add it all up, from top to bottom, the whole thing needs to be reinvented.

Trust Scoring

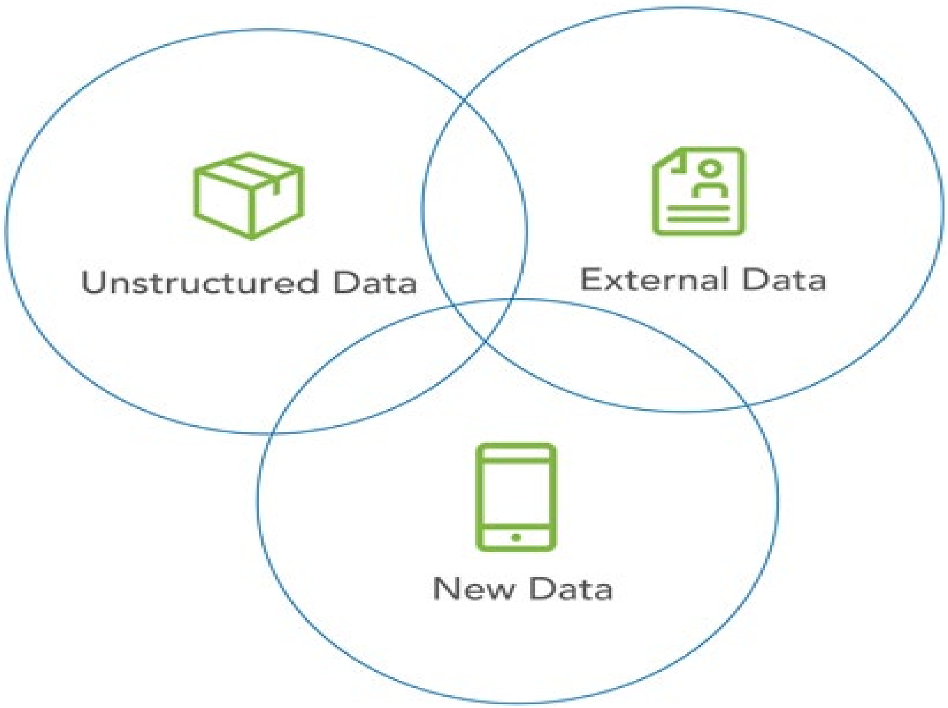
The market thus needs to be reinvented from the bottom up, and that process begins with Trust Scoring. The central tenet behind a Trust Score is that there are alternative sources of data - or 'metrics of trust' - that can be funneled into an engine/algorithm to determine a relative level of trustability of an individual.

According to a recent article by Tech Crunch:

> "If you're not working to build and demonstrate it, then the future might be about to leave you behind, as trust is quickly becoming the global — and most-valued — currency of modern time." The Future is the Trust Economy

The question is, where will these metrics of trust come from?

There are multiple sources that these metrics can be sourced from, many of which would be considered new or unstructured data.



As we move towards a new era of both financial services, insurance, and the 'trust economy,' we start to see that the real database for new metrics comes from the patterns of our daily life. Since the inception of the sharing economy following the '08 crisis, so many of these patterns are being captured on platforms, social network, and digital marketplaces.

Airbnb is one such platform that comes to mind. Those who have used the service, whether as a host or a guest, recognize the importance of trusting the other party. Airbnb's trust metrics are currently based on star ratings for the host and comments for both host and guest. Given that Airbnb is valued at $25.5 Billion and has over 2 million listings in over 200 countries, you would assume that there is a lot more that they can do with that data to develop new trust metrics. Many feel that their acquisition of blockchain startup ChangeCoin earlier this year was motivated to create a blockchain-based 'trust passport' to enable users to harness the trustability they have built up across other services in the sharing economy:

> "If Airbnb can figure out a way to make its user profiles immutable and universally readable, they could become a trusted form of digital identity, a bit like the profiles that credit bureaus create for individuals." The Financial Revolutionist - Briefing #24

And there lies the rub. It's not going to necessarily be a fintech or any other type of financial institution that will develop these new trust metrics for Trust Scoring. Since these new data sources could come from a platform like Airbnb, a social network like LinkedIn, or a digital marketplace like Amazon, the field is wide open for anyone that can figure out how to turn their platform data into a true trust metric.

Already, there are initiatives underway to create new ways of scoring for consumers in developing economies, where the credit score provides little to no value and leaves millions excluded from the financial system. Lenddo, Inventure, and Branch.co headline some of the players that are changing the way finance is done in emerging markets by looking at new data sources such as email patterns, mobile phone usage and other behavioral patterns. There is certainly a chance that some of these startups operating in emerging markets will unlock something that can be applied back to the developing world.

But in whatever way metrics of trust manifest themselves in the future world, the core concept of what it means to be trustable will radically alter the landscape of financial services. And being one the 'trusted ones,' to which we imagine there being many, needs to be rewarded handsomely.

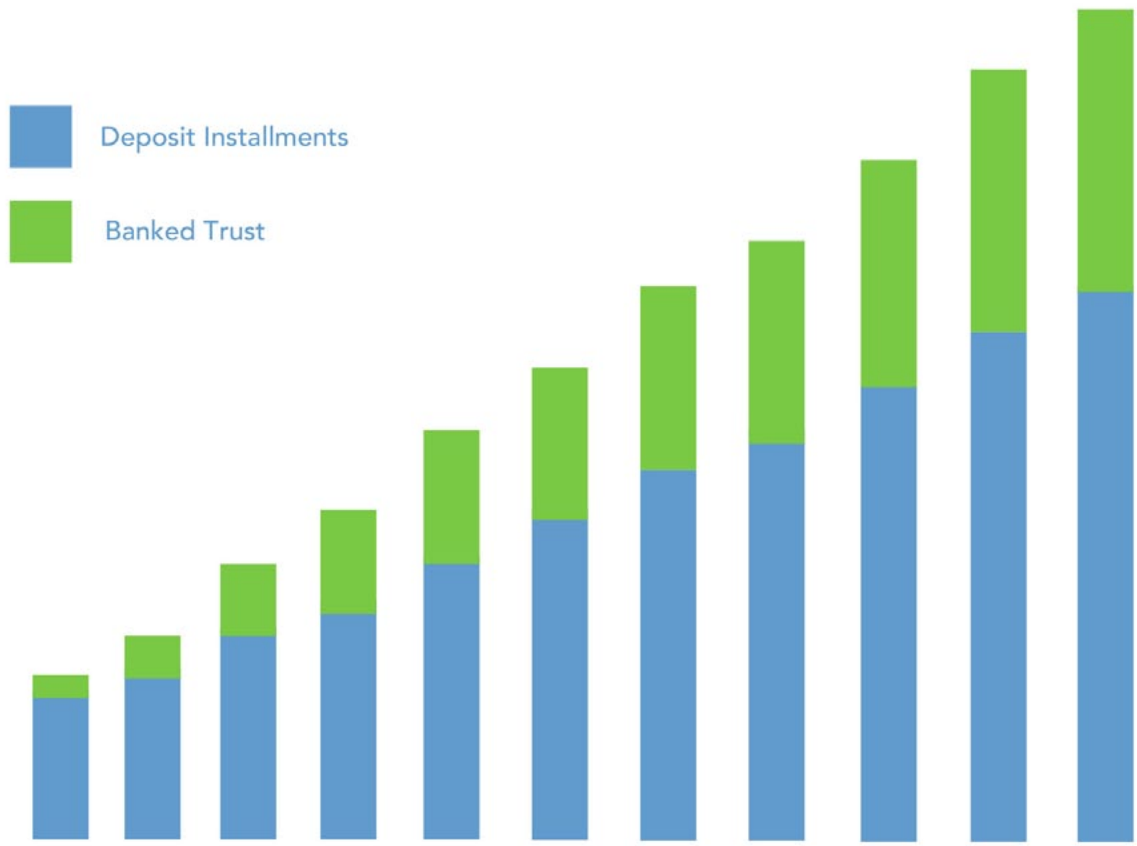
Trust as an Asset™

Imagine a world where being trustable really carries no tangible value, where you're only real advantage comes from things that can be measured by a paper trail in the traditional system. That's the world of today.

In the future world, we can imagine 'Trust as an Asset,'™ where your trustability will determine what products you have access to and how you access those products.

In an example where you had users depositing money into an account against a future outcome, you could see an individual depositing money into some kind of a fintech account, whereby their deposit is linked to something they want in the future but don't have enough money to afford today.

Let's take a house as an example. For Generation Rent, the idea of owning a house has slipped further and further from reality. Rather than offering increasingly more a home on credit at rock-bottom interest rates, what if we could leverage your trustability over time and turn that into your first down payment.



If, for example, you wanted to buy a house and the required down payment was $50,000. Now let's say your proposed horizon was, as a young twenty-something, ten years to buy a house. It will be very difficult to save $5,000 per year, maybe a little less if there was some kind of interest accrual on that money. But what if your trustability started to count towards knocking down other costs in your life - rent payments, insurance premiums, etc. - and by consequence you were able to free up more capital than you would have otherwise saved towards a deposit. That's the first benefit.

Then, let's say that the original $50,000 down payment actually became $40,000 after five years because of how trustable you became, which was reflected in your Trust Score.

Now, in theory, you would have knocked $10,000 off the down payment on the new home, plus saved another $5,000 (for argument's sake) over a 5 year time period from reduced rental rates, insurance premiums etc. Let's say hypothetically, that in that time period, you were able to save $3,000 per year towards a future house.

So you have $15,000 in the account from your down payment, plus you added all of your savings into the account (another $5,000), that would give you $20,000 towards your down payment. If you are now offered a down payment of $40,000, that still leaves a $20,000 gap.

But, what if, during that time period, your financial outlook vastly improves and you move from earning $50,000 per year up to $100,000 per year. Now you have a totally different scenario. There will be ways for institutions to bridge the gap, and you can increase the amount you are able to allocate to your down payment, meaning that you may be able to afford that house, comfortably and without any financial engineering, in six or seven years.

The whole thought process behind Trust as an Asset™ is that you light a path towards a future outcome that is really important to people, and use trustability as a metric to deliver real financial rewards, thereby rewarding good behavior and incentivizing savings towards an important asset rather than simply encouraging people to enhance their credit score and having them blindly hope that one arbitrary day in the future they can afford a house.

Our Future Selves

To bring it all home, we enter the next generation of finance via the digital adviser and artificial intelligence (AI). A lot of the early work in this area has been happening in wealth management and advisory, where a new generation of Robo Advisors are merging digital technology with financial advisory services. Research shows the power of computer simulation to help us achieve certain financial outcomes:

> “Research shows we are more likely to make better long-term financial decisions after seeing a computer-generated visual representation of our future selves.” Millennials and the Future of Finance

In the case of Trust as an Asset, there needs to be a feedback mechanism built-in so that users can see the effects of their actions translating into real gains. Also because:

> “we have a hard time internalising effects that will take place far into the future, an attribute which underpins most sound financial planning.” Millennials and the Future of Finance

If we can start to develop systems whereby our financial behaviors are incentivized around metrics of trust, rather than abstract metrics of a credit score, then we can expect to see people change their behavior in a corresponding way to achieve the outcome they want quicker. To do this requires a sophisticated look at current marketplace incentives in the context of the current ecosystem, versus a look at future marketplace incentive in the context of the future ecosystem. Because there are so many moving pieces, the advent of ML (Machine Learning) and AI can help to clarify this complexity and enable us to build accurate models of ‘our future selves.”

Technology and the new Distribution Channels

Before we can bring it all together, we need to also understand that it’s not just the products and services that are being completely changed, but also the distribution channels themselves. Social networks have paved the way for new models of eCommerce and engagement, creating new channels of distribution to Millennials:

Recent research from The Center for Generational Kinetics, Bazaarvoice, and Kelton Research explains that "Millennials won't buy without input from others" Millennials and the Future of Finance

Paykey is an example of a fintech that is capitalizing on this trend by enabling customers to send payments on social channels with their own bank account. Someone could thus send money to their friend via What's App right from their bank account. Social channels like Facebook, What's App, etc. are not only channels to engage customers, but also to acquire them:

"FinTech startups being built on the back of social networks have a distinct advantage over incumbents when it comes to customer acquisition" Millennials and the Future of Finance
There are several examples of new fintech players who have successfully leveraged the social and mobile channels in the current environment. Tilt, Able Lending and a host of others have scaled their model into Millennial markets on the back of these channels. And now we are on the verge of paving a new channel, Bots.

Bots are automated chat apps that run via messenger applications like Facebook Messenger, Kik, and Slack. The advantage to Bots over apps is that users are not required to download anything, create an account etc. Bots are opened simply as chats through messaging channels and create both a new distribution channel on digital and a new user experience. In relation to finance, We Chat, the leading messaging app in China, demonstrates the potential for Bots to revolutionize how financial services are delivered:

> "The new loan service relies on bank account information as well as data gleaned from a user's social network history to gauge a person's creditworthiness in seconds, the Wall Street Journal reported. How much you spend on restaurants and cabs, which are also part of WeChat's web of e-commerce, might help determine your creditworthiness. The loans can extend up to 20 months and carry interest rates staring at 0.05% a day, according to the Journal." A $30,000 loan in seconds from a Chinese social network

We Chat has more than 700 Million monthly active users:

> "If you start a business in China today, you will create a WeChat public account bot well before you have a web site." China's WeChat Foretells Facebook / Microsoft Bot Platforms' Future

And now, within the North American market, finance-based Bots are starting to enter the market:

[Kasisto wants to be the Ask Me Anything of Personal Finance]

In the future, we will be using be using Bots, which can blend both people and robots into the experience, to engage us and advise us in relation to our personal finances. In the interim, Bots represent a new distribution channel to test new applications and try and acquire customers for cheaper than traditional channels.

Tying Trust Together into a new Market Structure

When we bring together all pieces - Bots, social networks, data visualization, new data sources, Trust Scoring - and combine it into a new framework, like Trust as an Asset™, then we can create new market incentives and reshape an entire generation's view of financial services.

Millennials, the largest generation in history, are set to become the major driver of the economy and require a new financial services architecture, which is being ushered in by fintech firms today and blockchain banks in the future. As this new market structure takes hold and we see incumbents start to fall, trust will return to the market and allow the Millennials to start to realize their true financial potential.