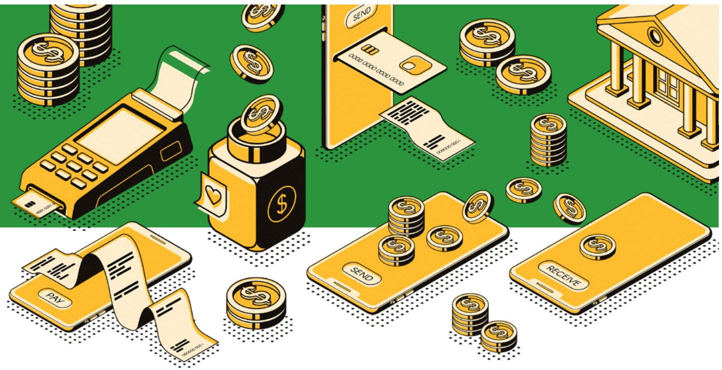


ETFS
Fintech & Blockchain ETF
Investment Case

Exchange Code: FTEC

WHAT IS FINTECH?

Fintech is a portmanteau of the words finance and technology.

A fintech company is a business that uses technology to enhance financial services. In so doing, fintechs unsettle incumbents – banks, wealth managers, insurers – and make financial services cheaper and more efficient.

Free share trading, instant international money transfers, robo-advice, digital wallets—we have seen much fintech disruption already. With blockchain adoption looming, the world steadily turning cashless, and the global payments infrastructure becoming standardised—there is still much disruption to come.

In this white paper we give an overview of the fintech industry and some of its major trends and opportunities.

FINTECH TODAY: 5 DISRUPTIVE THEMES

Fintech disruption is around us today as well. We believe there are five major fintech trends reshaping finance.

They are:

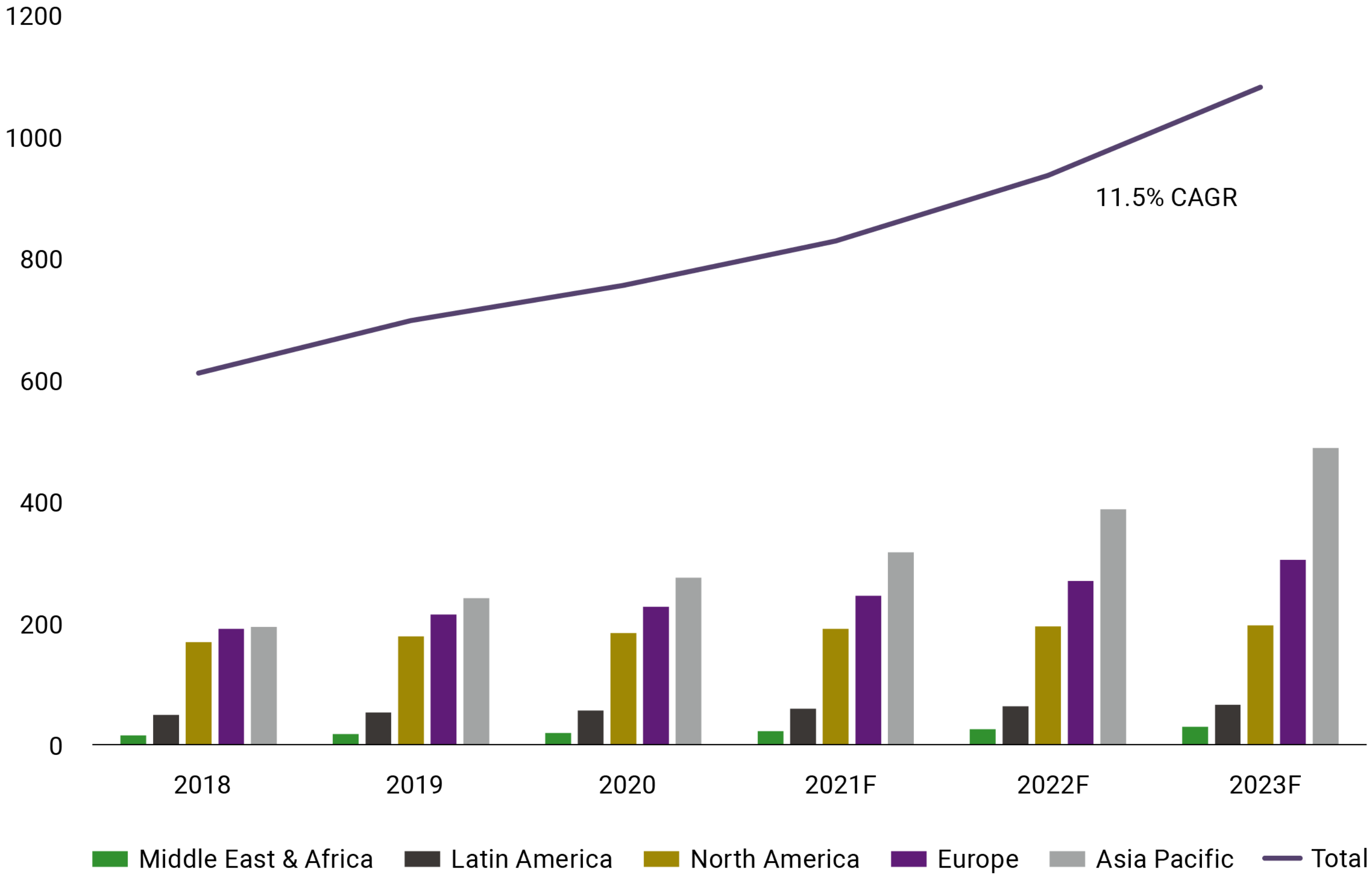
1. **Cashless society**
2. **Blockchain adoption**
3. **Wealth moves online**
4. **The rise of alternative credit**
5. **Cloud, big(ger) data**

Below we give a survey of these trends and look at what they have to offer investors.

1. CASHLESS SOCIETY

Businesses and consumers are using cash less than ever. According to a study from Capgemini, non-cash transactions are growing at a compound annual growth rate of 11.5%. There are several reasons that cash is dying. These reasons pre-existed covid-19, which has helped kill cash. One big reason is security. Card payments are easier to trace and audit, making theft harder.

NON-CASH TRANSACTIONS GLOBALLY (US$ BILLIONS)



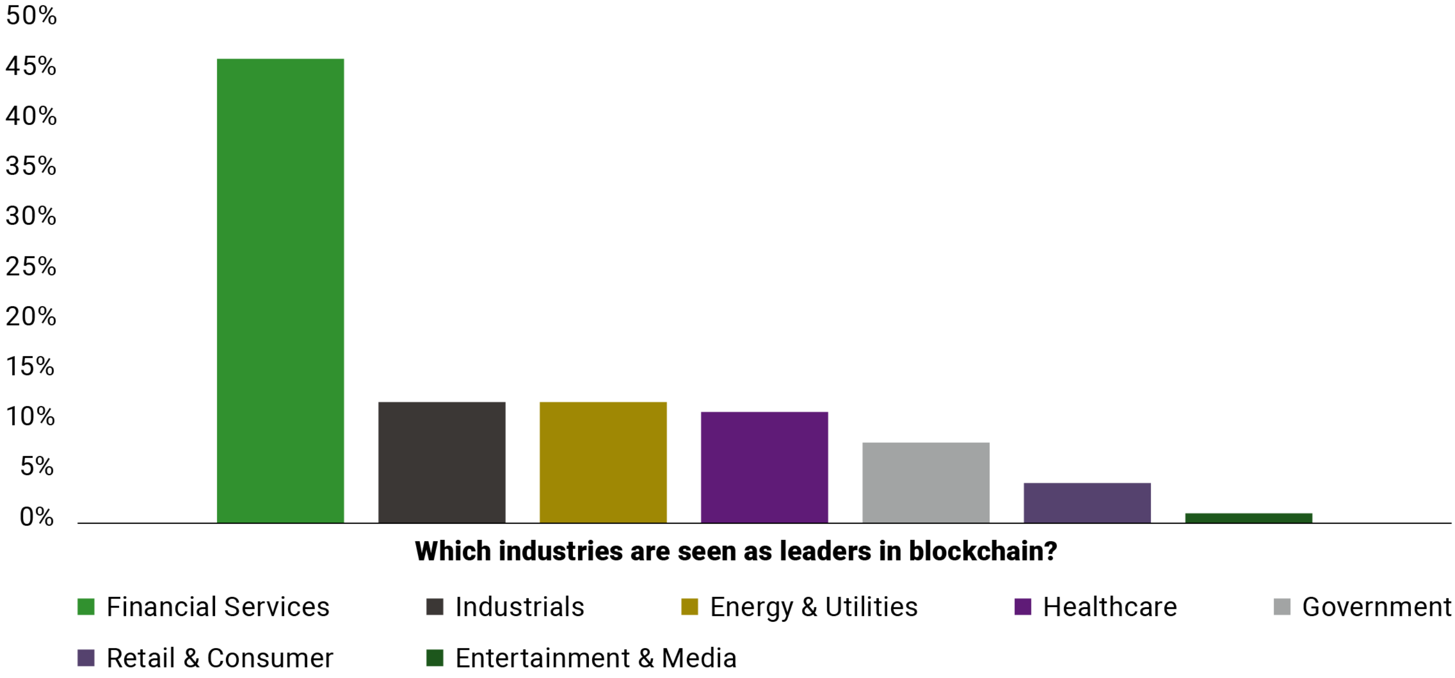
Source: Capgemini World Payments Report, 2020

Another big reason is the rise of online shopping, as Amazon and others only accept card payments. Smartphones are another reason. Smartphones have paved the way for apps – what are sometimes called "digital wallets" – that can manage cash online and more conveniently. PayPal's Venmo is one example of this kind of app. A final reason is that even small businesses, like cafes, do not need cash anymore. New point-of-sale (POS) providers – like Square – give free hardware to small businesses which enables them to go cash-free too.

2. BLOCKCHAIN ADOPTION

Blockchain is potentially the most impactful of the fintech themes. It is especially relevant for financial services with research by PwC finding that the finance industry is widely regarded as the most advanced in blockchain adoption.

FINANCE IS WIDELY REGARDED AS THE INDUSTRY LEADER IN BLOCKCHAIN ADOPTION



Source: PwC Global Blockchain survey, 2018

Cryptocurrencies like Bitcoin and Ethereum have shone a spotlight on public permissionless blockchain (open to all) and shown how, if used to its full potential, blockchain can end much of finance as we know it. Behind the scenes however incumbent financial institutions have been adopting private permissioned blockchains, which they believe could allow them to offer better services.

One major area of interest is "tokenisation". This is where assets – be it property, commodities, shares, whatever – are represented as virtual tokens on a blockchain. This has the potential to allow real assets – cars, houses, etc – to be traded like financial securities. Seeing this potential, global exchanges – including the ASX in Australia and HKEX in Hong Kong – have been working hard to put blockchain at the heart of their settlement systems.

Another interesting area is "smart contracts", which stores the terms of an agreement (i.e. contract) on a blockchain and automatically executes them. This can potentially avert some need for lawyers.

While promising, many of these blockchain use cases are still in the venture capital stage of investment. However, some cryptocurrency miners and custodians – like Hut 8, Coinbase – have begun to publicly trade in recent years.

3. WEALTH MOVES ONLINE

Fintechs are also disrupting how investors manage their money.

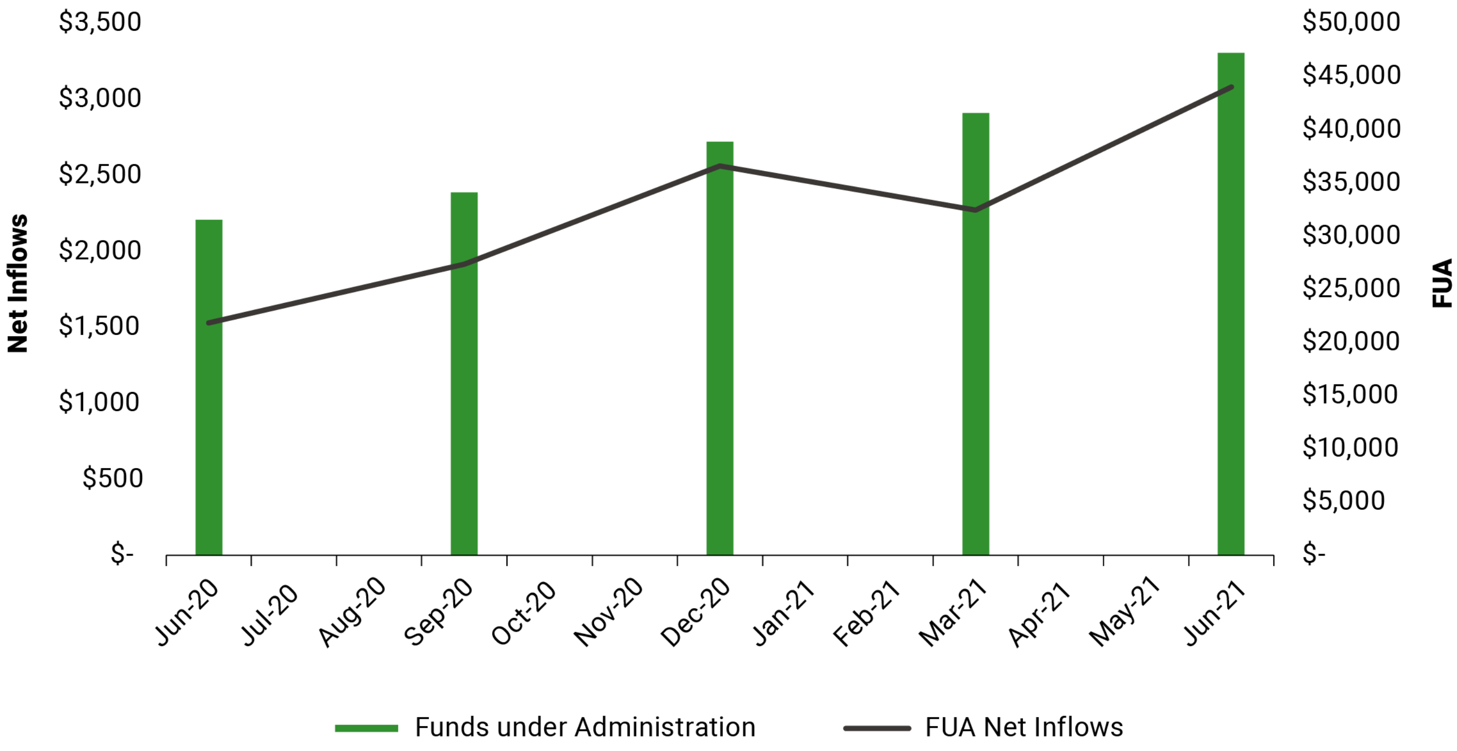
Fintechs like Robinhood have forced brokerage costs to zero, allowing them to rapidly amass a network of low-balance clients. Transaction costs have also fallen, moving to near-zero with the help of fintech market makers, like Virtu and Flow Traders, which specialise in trading on exchange.

ROBINHOOD'S AVERAGE ACCOUNT SIZE IS FAR LOWER THAN COMPETITORS	
Robinhood	$3,500
E-Trade	$100,000
TD Ameritrade	$110,000
Charles Schwab	$240,000

Source: Business of Apps, 11 July 2021

Fintechs have also opened access to financial advice. Automated financial advice – known as "robo-advice" – has given investors with lower balances access to personal advice (whereas traditional flesh and blood financial advisers typically require high minimums in liquid assets to take on a client). Flesh and blood advisers have benefitted from fintech too, as new online platforms – like Netwealth and Hub24 – provide them with a one-stop-shop for managing all their clients' portfolios.

NETWEALTH'S RATE OF FUA GROWTH IS ACCELERATING



Source: Netwealth June 2021 quarterly report

4. THE RISE OF ALTERNATIVE CREDIT

Regulations introduced after the 2008 financial crisis – known as "tier 1 capital requirements" – have reigned in the banks from making riskier loans. The regulations have had a particularly strong impact on banks' willingness to lend to poorer businesses and households, who carry a higher risk of being unable to repay.

ALTERNATIVE CREDIT COMPANIES WERE MOSTLY FOUNDED POST-2008	
Afterpay	2014
Zip Co.	2013
LendingClub	2006
Lufax	2011
Enova	2011

Source: ETF Securities

Banks' reluctance to make these loans has created opportunities for fintechs. And into this breach alternative credit fintechs have entered, providing the riskier loans to consumers. Afterpay's, which been acquired by Square, enormous success is largely explainable by these banking regulations. As its business model, based on "factoring without recourse", is largely off-limits for the banks.

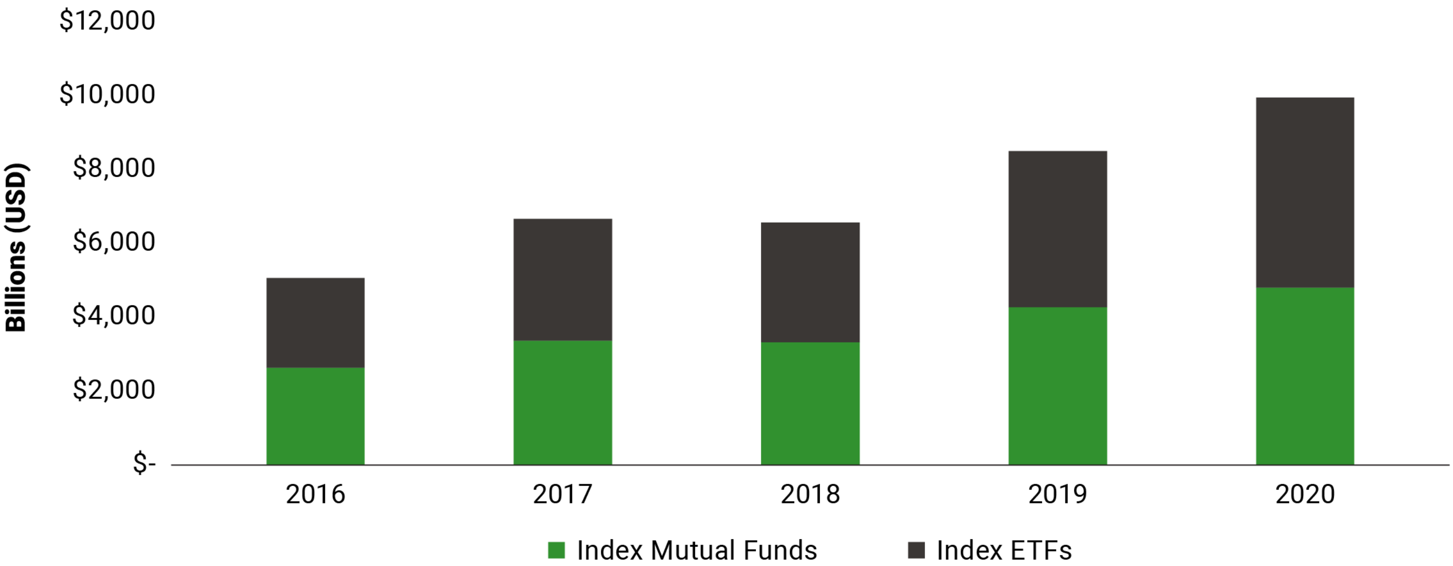
Fintech peer-to-peer lenders (P2P) like LendingClub in the US and Lufax in China have also joined this space. Rather than just targetting the borrowers like Afterpay does, they also target the lenders. They aim to identify consumers needing loans and match them with consumers willing to lend them money.

5. CLOUD, BIG(GER) DATA

Data has always been crucial for financial markets as it allows assets to be priced accurately and quickly. Data is also the fuel of automation.

There are many kinds of data that fintech companies are using. An example from our own industry – funds management – is index data, provided by companies like MSCI and S&P Global. Index funds have grown like wildfire the past five years.

ASSETS IN INDEX FUNDS HAS SURPASSED US$10 TRILLION



Source: Investment Company Institute Factbook, Data as of 31 December 2020

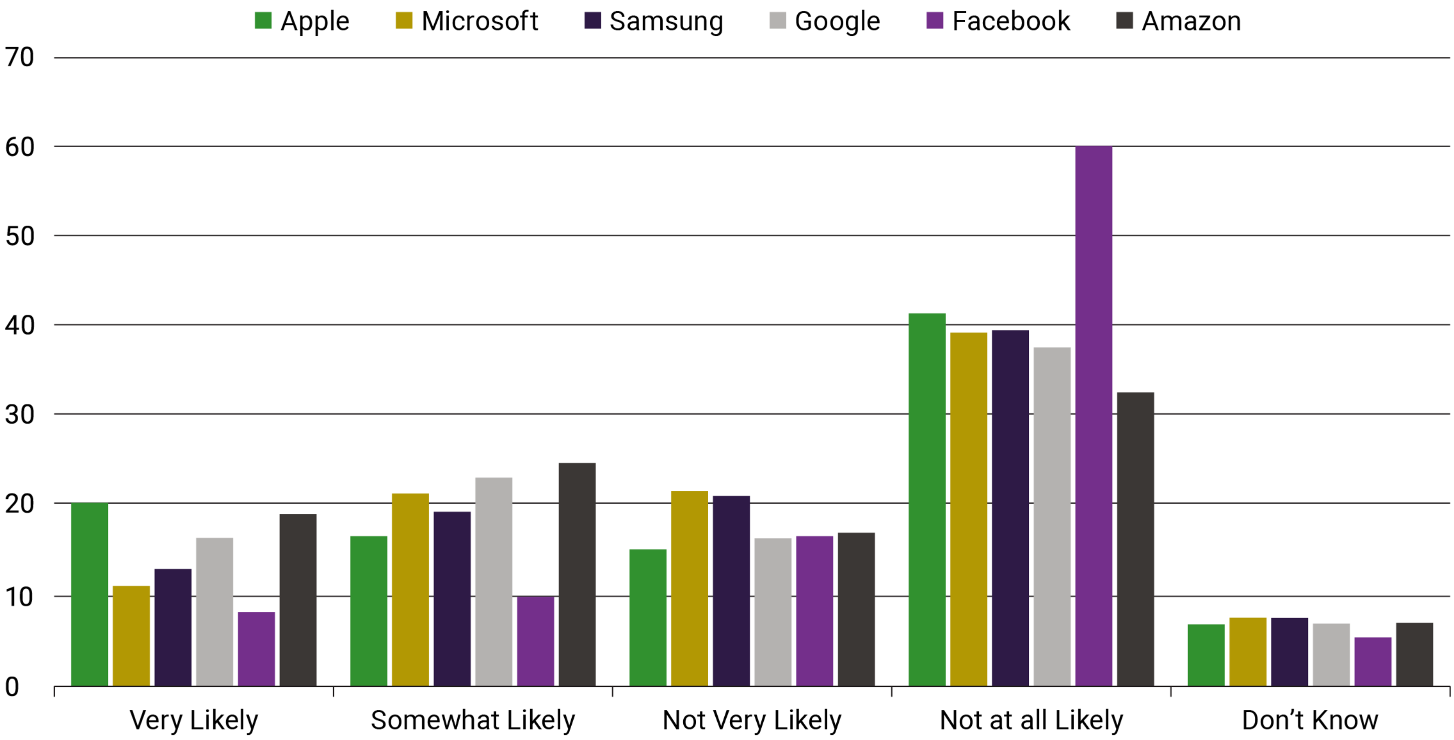
Personal credit and property data – from FICO and Black Knight – is another example. Mortgage brokers and the banks require data to accurately assess individuals' and companies' creditworthiness. This then allows them to decide whether to lend them money.

Sitting alongside software are fintech software companies, which are increasingly migrating to the cloud. Software companies are helping remove much of the drudge paperwork and time spent boring into spreadsheets – which there is no shortage of in finance. To give a local example, Xero, the Australian-New Zealand company, has built a platform that allows companies to monitor their revenue, cash flow and accounts in real time rather than periodically when they update spreadsheets.

CAN THE FANGS DISRUPT FINTECH?

A question sometimes asked of fintechs is whether the Silicon Valley technology giants – sometimes referred to as the FAANGs (Facebook, Apple, Amazon, Netflix, Google) – can enter fintech. And if so, could they threaten both established finance companies and disruptive fintechs (disrupt the disrupters). There have been some attempts. Apple and Google have launched Apple Pay and Google Pay to much fanfare. Facebook has launched its cryptocurrency Diem. Amazon, the driving force behind online shopping, has been a boon for online payments. Apple has also launched a competitor to Afterpay, with help from Goldman Sachs. The Bank of International Settlements, the central banks' central bank, suggests big tech disruption to fintech is likely in alternative credit.

INTEREST IN SIGNING UP FOR BANKING SERVICES PROVIDED BY BIG TECH COMPANIES (%)



Data compiled March 20,2020
Based on responses to questions asking if respondents would be willing to take banking services (eg. checking/savings) from certain big tech companies. N = 1,271, N signifies total number of respondents in digital payments of survey.

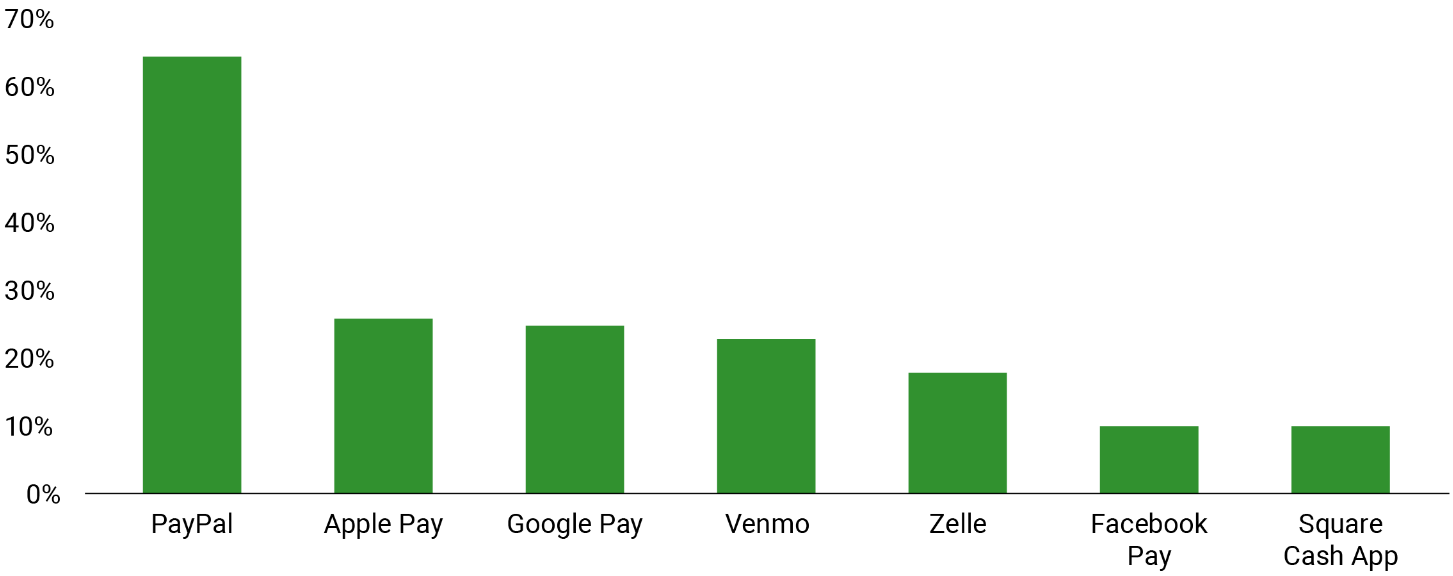
Source: 451 Research's VoCUL: Connected Customer, Consumer Population Representative Survey fielded between Sept. 30 and Oct. 25, 2019, across a nationwide sample of 5,000 consumers above the age of 18.

However from where we stand the FAANGs, while formidable businesses, will be unlikely to make significant inroads into finance and fintech. There are several reasons for this.

The first is that the FAANGs have other strategic priorities that better complement their capabilities. Priorities differ between them, but video games, the streaming wars, and cloud computing, are common to almost all five of them. Of these, video games is the most universal with Amazon investing in Twitch and Luna; Apple in Arcade; Facebook in Facebook Gaming; Google in Stadia and YouTube Live; and Netflix most recently announcing a new initiative. There is little evidence that disrupting finance is a major priority for senior FAANG management as of August 2021.

The second is that, and while it is hard to generalise about a broad industry, fintechs are usually highly-specialised scale players selling into other businesses (B2B). The specialisation means that there is little overlap with the FAANG's products or services, which are mostly business-to-consumer (B2C). Competing with fintechs is therefore capital intensive and requires building products from scratch and specialised financial areas – be it credit rating, electronic market making, or digital wealth – are unlikely to be of interest to the FAANGs.

PAYPAL IS THE MOST USED PAYMENT APP IN THE US



Source: Cornerstone Advisors survey of US consumers, October 2020

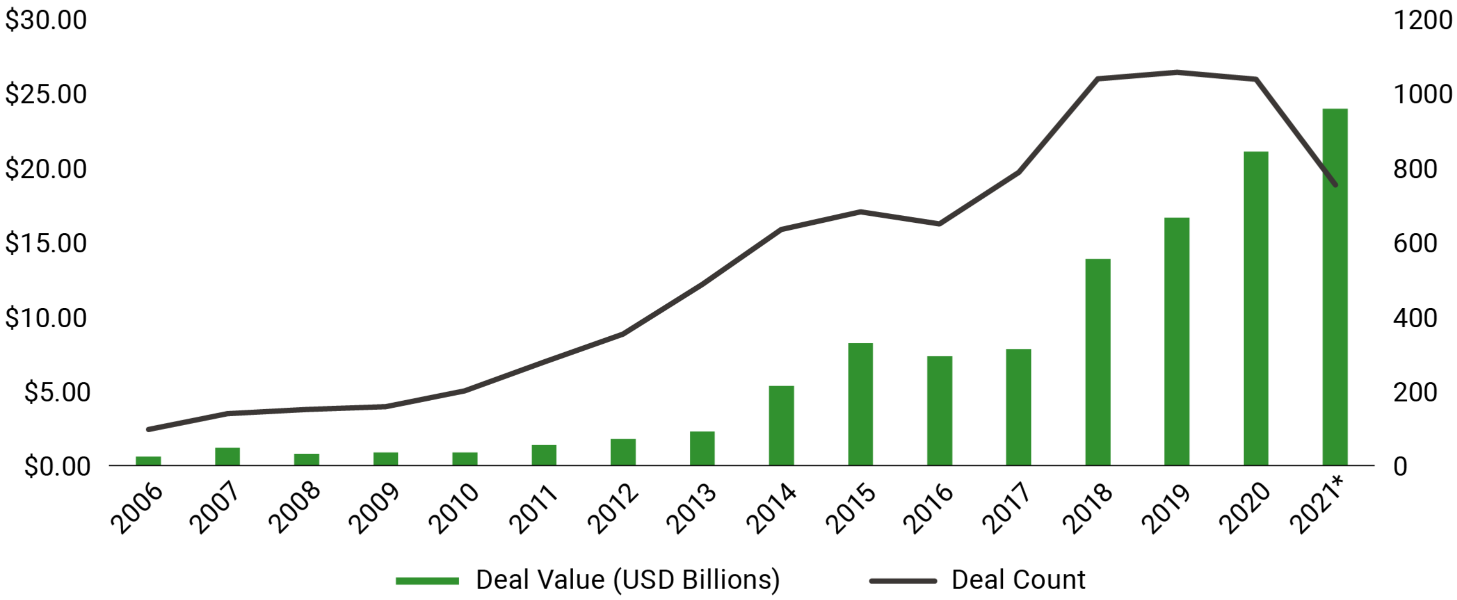
The third is that relationships with financial institutions are often sticky. Australians and Britons, for instance, are more likely to change spouse (get divorced) than change bank. This has meant that in the area of fintech that the FAANGs have made a focussed effort – payments apps – they have struggled to stem the growth of PayPal and Square.

Nonetheless the FAANGs could represent a threat to consumer-facing fintech companies. It is still early days. And there is no harm in diversifying, potentially owning the FANGs (such as via an ETF) to complement fintech exposure.

CAN THE BANKS AND BROKERS STRIKE BACK?

Another question sometimes asked is whether the banks and brokers can fight back and reclaim ground from fintech companies. There have been efforts. JP Morgan has launched a square card reader to take on Square. Deutsche Bank launched Robin to take on robo-advice. Charles Schwab lowered its trading costs to zero following Robinhood.

FINTECH INVESTMENT FROM US VENTURE CAPTITAL IS SURGING

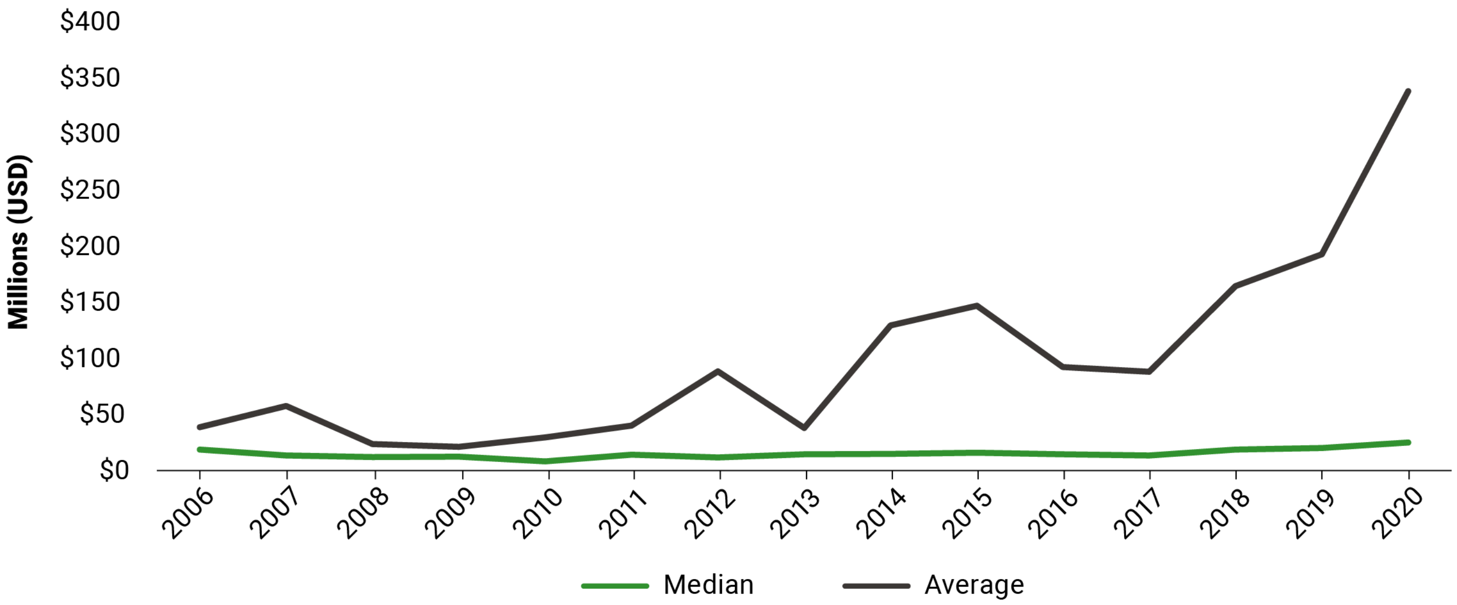


Source: PitchBook, Data as of 31 June 2021. US venture capital investment in fintech

However the relationship between banks and brokers on the one hand, and fintechs on the other is not so straightforward. On the surface, much of what fintech companies do banks and brokers can just do themselves. As JP Morgan CEO Jamie Dimon said in the company's 2019 annual report: "companies like Square and PayPal have done things that we could have done but did not. They looked at clients' problems… and moved quickly."

This may imply that incumbents can fight back against disruption. Yet on the other hand, the banks are the biggest clients of many fintech companies: fintech software firm Temenos exclusively services banks. In many respects the high valuations and intense venture capital investment in fintech start-ups (graphs above and below) reflects their being acquisition targets for incumbents, suggesting long-term compatibility.

THE VALUATIONS OF FINTECH RECEIVING VC INVESTMENT IS RISING



Source: PitchBook, As of 30 June 2021. Median and average US VC fintech pre-money valuation.

ACCESS IT WITH FTEC

For those wanting to access this promising sector, the ETFS Fintech & Blockchain ETF (FTEC) provides a solution. FTEC tracks the Indxx Developed Markets Fintech and DeFi Index. The index is made from companies derived from several fintech subthemes, including: digital payments, point of sale, peer-to-peer lending and crowdfunding, personal finance software—and more. It holds Afterpay, Zip, Xero – and many others. Companies are chosen based on revenue purity, to ensure they truly fintech businesses. It aims to capture the major trends we are seeing in fintech discussed above.

For more information on the ETFS Fintech & Blockchain ETF (Exchange Code: **FTEC**), please speak to ETF Securities.

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