diffusetap
Virtual Event Series

Pay for Everything with Your ETF

Guest Speaker:

Fred Phillips
CEO
Investor Cash Management

Hosts:

Kenny Estes
CEO & Founder
Diffuse

Ayla Kremb
COO & Co-Founder
Diffuse

DiffuseTap: Pay for Everything with Your ETF

Last time on DiffuseTap, Fred Phillips, CEO of Investor Cash Management, talked to us about how ICM enables retail customers to pay for everyday items with securities, how this helps close race and gender gaps in investing, and why big players like Visa and MasterCard have invested in this new payment solution.

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DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas)… straight from your armchair like a boss.

Meet the Speaker

FRED PHILLIPS is founder and CEO of Investor Cash Management. ICM transforms specified investment funds into digital transaction currencies, enabling customers to seamlessly pay for card purchases with securities such as government money market funds and ultrashort bond funds. As a result, banking clients can obtain returns 40X higher than average bank interest rates.

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We are an alternative fund platform offering differentiated investment products. From digital assets to VC funds and beyond, we identify green field investment opportunities we feel will have market beating returns and turn them into professionally managed funds. For more information, visit www.diffusefunds.com.

KENNY ESTES: Let's hear from Mr. Fred Phillips. Mr. Phillips, do you want to tell the good folks a little bit about your background and what you're up to over at Investor Cash Management?

FRED PHILLIPS: Thank you for the invitation. I'm delighted to be here. I'm Fred Phillips, founder and CEO of Investor Cash Management, which is a fintech company. We are the youngest company that Visa invested in, and our investors include the former chairman of MasterCard, who led them through their IPO, Joe Mansueto, the founder and chairman of Morningstar, John Rogers, the founder and chairman of Ariel and who is also on the board of McDonald's, Nike, and The New York Times.

Our core infrastructure partners apart from Visa include Bank of New York Mellon, and we made BNY Mellon Investment Management our custodian asset manager. DriveWealth is another custodian and alternative asset manager of ours. Prior to this, I directed financial services and financial technology investments for the Carlyle Group, a large private equity fund. We had a $1.2 billion dollar fund for this. Prior to that, I did the same for ABN AMRO, which was among the world's largest banks.

KENNY: Okay. That is exciting and quite an impressive list of investors and partners. Visa and Mansueto are definitely well known names around Chicago at a minimum. What is the core product over at Investor Cash Management? What's the pitch?

FRED: So, in the same way that Diffuse Funds tends to use fund products, Investor Cash Management's core product is an investor cash management account. It took us a substantial amount of time to name that. What our product does is it links concurrently to a bank account and FDIC bank account, and through the brokerage platform to various asset management products.

What makes our product unique is that we can provide immediate liquidity on not only the bank account, but also the mutual fund or ETF. For example, Kenny can take Ayla to lunch and pay with an ETF and mutual fund, or a defined portfolio of ETFs and mutual funds. Or more simply, Kenny can be liquid and invested at the same time.

To anticipate the question of why anyone would want this, the current national average, which the FDIC updates every Monday morning, is 7 basis points on checking. A government money market fund in an average share class would be 500 basis points. So, you can literally get 70 times your money while retaining the same liquidity through a debit card through an ATM, Apple pay, Google Pay, peer-to-peer transfers like Venmo or Zelle, and an integrated online bill payment product.

KENNY: Okay, so how does it logistically work? Is this a margin product?

FRED: That's a really good question. That's a great question. Margin, as many, if not all on this call know, is a credit construct. The way that one would typically do this in the past would be, for example, you have a million dollars in your brokerage account invested in various products. Depending on what those products are and their volatility, you can perhaps get a 70% margin. You then have a credit line of $700,000.

The problem with that is when I transact margin, interest typically will accrue from the moment I transact until I paid that margin loan back, plus whatever is the accumulated interest. So even if it is a debit card linked to a margin product, what I have done is I transformed it into the world's most expensive credit card, because there is no grace period.

So, what we do is a pure debit construct. I co-founded a company in the UK called ACCU Card, which we eventually sold to Lloyds TSB, a large British bank. From my experience building a credit card company, one of my resolutions was that I never wanted to have to fund credit lines again. One of the great advantages of our product and what makes it more profitable for us is that we are basically using a different settlement cycle that enables us to go ahead and use a debit construct without funding receivables.

KENNY: Interesting. Okay, so I go buy lunch for 100 bucks, and you immediately then sell the underlying assets, get the proceeds, and then you credit the proceeds back up to pay the vendor.

FRED: Yes, that is broadly correct. To be a little more granular, the way that works is, let's assume that everyone on this call happily is using our product. Different people are doing different things. Ayla is funding her account, AJ is direct depositing, Chad is transacting from an ATM, Ray is buying different things with his debit card, Lil is doing different things through online bill pay, and Greg is doing stuff with Apple Pay.

What we do is, at the end of the day approaching market close, we will go ahead and see what the inflows are for a given product. For example, the PIMCO Mint, which is an ultra short bond fund ETF. We will see what the inflows were into that product. We will see what the outflows were. We will cross that on our end, and then we will send the custodian a single trade along with an allocation file saying “this much of this trade”.

The custodian then loves us because it's hyper efficient. Even if you have an enormous number of transactions, you are only getting one instruction per day to “buy this” or “sell that”, and then we send an allocation file via API to say “this is what corresponds to each individual user account.”

KENNY: Okay, interesting. So, you are netting inflows and outflows on a per product basis, and then you are just doing the one transaction at market close, effectively.

FRED: That is exactly right. So, with the ETF, it's not like if Ayla buys something with our debit card at 11:23 in the morning, then we are using that price. Or if Aaron does something at 12:04, we are using that price. We use the market close price, and of course that is disclosed in the documents.

KENNY: Interesting. Okay, that makes total sense. Ray had a question here for you. But you are doing this now as the centralized party. Can this be done on a P2P basis without having a debit card in the mix?

FRED: You can, for example, link our account to Zell and Venmo, if that is what you would like to do. You can also do it via Apple Pay and Google Pay. But at some level, you are using the debit card when you do that.

KENNY: Understood. And then, that ties back to the question. You mentioned that Visa is one of your significant partners and investors as well. They are well known for credit cards…

FRED: And debit cards.

KENNY: Okay, and debit cards. So, is it a debit card partnership?

FRED: Yes, it is a debit card partnership. One of the things that we've thought about is issuing a product that would be a secured credit card. But rather than the money being in a bank account earning no interest, we wanted to have it placed in a security or portfolio of securities, the idea being that the security should increase in value at a greater rate than a bank account. And then, your credit line can go up.

One of the things that we would emphasize is that we serve a pretty broad socio-economic base. Earlier this year, we won an award that was sponsored by Stanford University, John Hopkins University, EY, otherwise known as Ernst and Young, for being the most socially impactful company in the United States with respect to finance.

But then, you can also offer things through very high end wealth management firms. So we do serve a broad socio-economic arc, and we're proud of that.

KENNY: Sorry, I'm not tracking. What is the socio-economic angle?

FRED: We are focused on the US, but this goes for many other countries as well. There is a yawning racial and gender investment gap in the United States. Now, to use our product is essentially to become an investor. That is because when you enroll in this product, which is a digital enrollment that takes roughly three minutes, we are recruiting this brokerage account for you. And so, if we do programs, for example, with HBCUs, historically black colleges and universities, as we've done with Delaware State, then every person who uses that product becomes an investor. That's the inclusion part.

KENNY: Interesting. Okay, so they don't have to have a brokerage account. They can use you for all debit purposes. But then, with this debit card, there's certainly higher risk because you are going to have the market volatility from the actual underlying ETF exposure. But at the end of the day, at least they are in the market, even if it's only a small amount of whatever cash they have on. Was this the intention?

FRED: Yeah. You make another really good point. We can link to anything. I mean, we can link to stocks. We can link to anything that has a T+2, or a shorter settlement period. We can also link to crypto by integrating it, which we have not done yet. But we can do it in one of three ways. We could integrate into your crypto custodian, and then we would be linking to crypto the same way that we linked to ETFs or mutual funds, via purchasing or DriveWealth.

The second is that we can go ahead and link to ETFs that track, for example, the Bitcoin futures. And then, I am probably the least knowledgeable person on this call with respect to the third possibility, but I think it is exceedingly likely that in the near term, you are going to have an enormous number of crypto ETFs. I think Gensler has lost that fight, and I think that they are going to be coming to market in the coming year.

KENNY: I don't know, I mean he responded to the Congressman asking him to approve one, and he responded a half-hour later, telling him to sit and spin. So I think he is going to go down fighting. We'll see. A question here from Ryan, and I think you've answered this. What is the wallet infrastructure for options?

FRED: Yeah. That is yet another great question. We can link up to 30 sub accounts, which is a crazy high number. No normal person should ever want anything approaching that, but I will explain why we did it. It was not just a fit of madness, although we certainly do things in fits of madness. But this was not one of them.

This goes to a point you made a moment ago about volatility, Kenny. For us, in the current environment, a reasonable contract would be for wallets or sub accounts. I mean, wallets and sub accounts are the same thing. The first would be, for example, an FDIC bank suite program. The second would be the stable NAV government fund. The third would be an ultra short bond. The fourth would be a short bond fund.

The point is, you are completely correct. With the ultra short bond fund, there is certainly a prospect of loss. There is certainly going to be volatility. But the expectation is that over time, the yield is going to be very substantially higher than what it would be in an FDIC banking account.

One way of thinking about our products in a sense, this is a liquid bond ladder. We would actively discourage anyone, for example, from linking it to a high yield debt fund. We would discourage people from linking it to a REIT. We think that doing Kazakhstani energy futures is probably a really bad idea for how you should be using your cash.

We think of it more as a separately managed account for cash where, as we were saying in our breakout session, if you have a choice between putting money in a bank and earning a national average of seven basis points, or even if you are hyper conservative, putting it with us and earning 500 plus in an NAV government money market fund, we like to think that it is self evident that people would rather get 70 times more on their money.

So, if you are a crypto person, we are not telling you to move your money out of crypto. What we are saying is, presumably you are investing in crypto because you think that is going to generate medium to long term wealth, and that's great. Whatever money is there, that is sacrosanct. We don't want to compete for it. We don't want to cannibalize it.

What we're saying is, use this as a centrally managed account for cash because it is a better way of transacting than a traditional bank. If you have a core brokerage account with your wealth manager in these 60-40 equities fixing for example, that is sacrosanct money. We don't want to touch that. What we are saying is, this is just a way for our partners to capture off-platform cash.

KENNY: Right. That's fascinating. A quick question for you from Darrell. Is this US only right now?

FRED: Yeah. I am really impressed with the quality of questions. Yes, today it is, but we really hope that that changes before the end of the year. And by the way, for all of you who are into Islamic finance, we actually have a certification from the company called Yasaar, which does the Sharia certifications for the London Stock Exchange and FTSE Russell, that our product is Sharia compliant so long as we link to Islamic securities, and an Islamic bank account. That may give you some insight into where our minds are going with regard to expansion.

KENNY: I guess it makes sense because you're not paying interest. You get appreciation instead.

FRED: Right. It is profit sharing in the literal sense, and becomes an interesting way of distributing Sukuk, which are Islamic fixed income products or Islamic bonds.

KENNY: Do you get a lot of uptick in that market? I'm just very curious. Is that resonating there? Is that a lot of your client base right now?

FRED: Well, no. It's zero of our client base right now. We have not launched there, but we are very focused on that. One of the interesting things is that among all the GCC countries, and they're all different, in Saudi Arabia, you are obligated to be an Islamic bank. You cannot have a banking license without being an Islamic Bank. In Qatar, you have a choice. You can be Islamic or conventional, but not both. And in the Arab Emirates, you can be both. You can be Islamic with a conventional window, or you can be conventional with an Islamic window.

But the interesting thing is that among all six countries in the GCC, the largest shareholder of every financial institution is a sovereign. For us, the motivation from the sovereign's perspective is to build a retail investment market, almost like an inclusion point, which is currently conspicuously lacking.

KENNY: That makes a lot of sense. Interesting. So, obviously you have a lot of institutions and big players. What is the core innovation that they were most excited about?

FRED: On how it is that you could transform an investment product into digital currency. When Al Kelly was the CEO of Visa, when they made their investment in us in April of 2021 (in fintech years, that seems several lifetimes ago), his view was that today, there are trillions of dollars that flow through Visa rails linked to bank accounts.

If you look at the value, there is roughly $18 trillion in the US banking system. To put that stupefying number in context, the amount of money that Bank of New York Mellon alone custodies is roughly $45 trillion. Think about that for a moment. Bank of New York Mellon globally custodies an amount of money that is two and a half times the US money supply.

So, Al Kelly was like, "wait a minute, we've always been focused since inception on bank money. What we are missing is that this is the tail of the dog. It's everything licensed securities. If we, Visa, could start getting not only banks like Citibank or Chase or Guilford Savings Bank as our clients, but also BlackRock and PIMCO and State Street, the bet for us is a small bet with what we very much hope will be a meaningful return for them."

KENNY: Gotcha. That makes sense. That then begs the next question of due diligence. These folks have no joke in terms of due diligence.

FRED: Oh, yeah. There is an awful lot of understatement in your comment. In one glorious moment, not to not to speak out of school, Visa's legal counsel, at least for our transaction and for a lot of their transactions, is a San Francisco-based law firm, Morrison and Foerster. A long time ago, I went to Yale Law School, and it was incredible. There was one call where we kept on trying not to smile on the call. There were more MoFo lawyers than we had employees at our company. It's just weird.

But there is a saying in Spanish that there is no bad from which good can be extracted, "No hay mal que por bien no venga". The point is, it was a brutal due diligence process, because they only have one due diligence process. They're like "oh, we're going to invest in Square or Block, here's our process. We're going to invest in Stripe, here's our process. We're going try and buy Plaid, here's our process. Oh, here's this little obscure fintech company. Well, we have this process."

It's a Nietzsche thing that whatever doesn't kill you makes you stronger. We have benefited a lot because, now that I've winced a little bit about the process, I can see the good of the process. They looked at our AWS infrastructure, and they said, "oh, this could be so much better if you were to do this, this, this and this." They helped enhance our AWS infrastructure in a way that was quantumly better than what we could have done on our own.

They looked at our PCI, or payment card industry. They looked at our security, and they enhanced it in ways that are qualitatively different than what we could have done on our own. They have some amount of economic insights. They are a fabulous partner. It's almost like having the world's worst father-in-law until after the marriage. There is a lot of good that comes from this.

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