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# Bloomberg Markets

## Maverick Managers

Fidelity Investments' **Kathy Murphy** and **Abby Johnson** talk about free index funds, cryptocurrencies, and how women are changing money management



# *Abby Johnson & Kathy Murphy:*

# *"Let's prove we can do something new"*

By MARGARET COLLINS and CHARLES STEIN

PHOTOGRAPHS BY M. SCOTT BRAUER



**IN AN ERA OF LOW-COST** index funds, it's tough to be best known for your stockpickers. Fidelity Investments, the 72-year-old family-controlled company, made a splash in August with the industry's first zero-fee index funds. Abigail Johnson, who succeeded her father as chief executive officer in 2014, gave a rare interview to *Bloomberg Markets* and brought along Kathleen Murphy, who leads the personal investing unit responsible for the new funds. Fidelity earned a record $5.3 billion in operating income in 2017, but investors continue to pull money from its active equity funds. The company also grappled with sexual misconduct allegations last year. At their Boston headquarters, Johnson and Murphy, who turn 57 and 56 in December and January, respectively, discussed the challenges of their changing industry. "We need to find other ways to get people to give us a try," Johnson says. ▸

**BLOOMBERG MARKETS:** One of the biggest investing stories this summer was the launch of the first two zero-fee index funds, by Fidelity. For a lot of people, it was a surprise that it was Fidelity. Why the free funds?

**KATHY MURPHY:** We wanted to have more people give Fidelity a try by offering these funds, but it wasn't just the funds. There were three components of that announcement: the zero-fee funds themselves; being the first in the industry to eliminate all [investment] minimums and account fees; then the third thing, which is probably the most influential on the market, is the reduction [in the number of share classes] of all of our index funds. As we've grown our index funds, we've doubled the assets in our index funds. We're the No. 2 provider of index funds in the country.

**ABBY JOHNSON:** I felt strongly about getting rid of the minimums. I just felt like they had outlived their purpose. When you get as big as we are, and we're trying to reach so many different people, to have a barrier like that just felt wrong.

I'm very down on conventional advertising. Kathy still spends a lot of money doing it, and her team members make a very cogent pitch that it's actually money well spent, but I think that conventional advertising will be less and less the way of the world.

We need to find other ways to get people to give us a try. Having a no-minimum, no-fee offering seemed like a pretty good way to get people to consider us with the minimal amount of friction possible.

**BM:** Were you surprised at how much it instantly affected some of the stocks of your competitors?

**AJ:** Yeah.

**KM:** Yes.

**BM:** Why do you think that happened?

**AJ:** Well, as a former stockpicker myself, when you're an analyst or a fund manager, people react to short-term news. There's often a knee-jerk reaction amongst investors when something that seems less-than-positive comes out. Most of our competitors are strong, smart operators, and they will figure out how to stay in the game. Maybe we caught them a little bit by surprise.

**KM:** Maybe. It was also a slow summer news day.

**BM:** People said, "Free? What's the gimmick?" People said you were going to make money on securities lending and all of these things that turned out not to be the case. Why does it make sense?

**AJ:** It's very challenging to make money on small accounts. The benefit seemed worth it.

**KM:** Index funds are essentially commodities. They're very low cost to start with. So taking the leap and going from 0.03 [percentage-point fees] to zero is not that big a leap, right? That's No. 1. The second thing is, we have given a lot of things for free. We don't say, "Free financial planning," but it is. It's part of our overall value proposition.

**AJ:** I think there's a fundamental challenge in our industry. Our core mission centers around trying to bring this complicated world [of investing] to people who are not experts in a way that they can figure out and navigate and ultimately make a plan for themselves.

One of the many things that is complicated then is to figure out how to charge for it. You can't charge for every individual thing, because then people would never be able to understand what they were paying for or how much. Part of what you're trying to balance here is—and the regulators certainly push us in this direction, too—is to have some kind of a fee regime that's understandable for people.

**BM:** If you're going to develop a relationship with someone, what do you hope to sell them or to offer them that they'll eventually pay for?

**AJ:** I'd like to think that people will continue to pay for active management. That's the core value proposition that we've been known for forever. If you look in the brokerage world, we charge very low commissions, but we give the best execution.

**BM:** Of the four main business lines—workplace benefits, personal investing, asset management, institutional—which is the most profitable, and which do you think will be the most profitable five years from now?

**AJ:** Asset management is the most profitable business. I think that would be true if you looked at outside companies. Asset managers are generally more profitable than broker-dealers and certainly more than workplace administration providers.

Over five years out, it's very market-dependent, because in asset management you charge basis points. If the market goes up, then you get more revenue. You can usually get the benefit of some economies of scale. When the market goes the other way, you get that leverage on the downside as well.

I try not to have an opinion about the market. I often feel like people expect that I'm going to have some strong view on the market. I think as a leader of the organization that has to find a way to keep going no matter what the market environment is, that's actually not a good headset to be putting yourself in.

One of the things that's fun, that I really like about our business, is that we're not just in that asset management box. We're doing a bunch of other things, too. So much market share has shifted to index funds, and we were late to that game. I like to think that we've caught up now.

**BM:** The name change to Fidelity Index Funds in 2016 helped, getting rid of the Spartan brand used since the 1990s.

**KM:** That was a bit of a self-inflicted wound.

**AJ:** That was definitely a self-inflicted wound.

**KM:** Once we called it Fidelity, we got a lot more assets.

**BM:** Was the original thinking that they didn't want the new funds to be confused with Fidelity?

**AJ:** I don't really know. I think the idea was that somebody thought it was like this New England Yankee thing and that people would say, "Spartan, it's spare." I'm speculating a little here, but I've got some insight. I think there was a little bit [of thinking] that it would be more Vanguard-esque to have that really explicit commitment to being bare-bones.

**BM:** Fidelity was late to the index-fund game, but it's come on strong. Do you think there's any challenge to saying, "We're somebody who will sell you both active and passive funds"?

**AJ:** Over the last however-many decades, we've learned a lot about what it takes to be really good in active management.

What it takes to be great in index investing is really two things. It's low or, now, no fees and really great service, and so that's what we're doing. From a customer perspective, I can understand they're looking at index investing and active investing as two things on the same shelf. From the point of view of running the business, they're very different in terms of what you have to do.

I don't have any problem with that at all. If we decide to do something, I want to be really good at it, so that's what we're going to go do.

**BM:** Fidelity about a year ago had some sexual-harassment issues internally. Abby, you actually spoke about it. You're certainly the top woman leader in asset management. What is one of the things you've learned in all of the discussions and meetings that you've had about this over the past year?

**AJ:** It's so complicated. It's hard to know where to begin. It was pleasantly surprising to see the amount of positive energy. People really felt concerned and had a desire to create some change.

**KM:** For me, both personally and professionally over the course of the last year, the discussion about unconscious bias has been very helpful and productive.

For example, we've had an effort over the last three years or so or longer to increase the diversity in our branches. This year half of the new hires in our branches are women, and that's in an industry where less than 25 percent of licensed professionals are women.

That required a talk with a lot of male managers about how we hire and how you interview and who you gravitate towards. It's not conscious, it's just that you're comfortable with what you know. We've also done it in what we call our Leap program, which is for younger technologists, and so half of the new technologists in this Leap program are women as well. What will attract more women? Flexibility. We really don't care when someone comes to work and when they leave, as long as they're doing their job. Give them the laptop so they can work at home, that kind of stuff. That doesn't just benefit women—these policies benefit everybody. Men want to go to their kid's soccer game as much as the woman does, right?

**AJ:** When I started in the industry, it was just expected: You want to be in this business, you've got to be around when the markets open. Technology has helped us to change that a lot.

Back on your original question: We had some outside help come in to help us facilitate some conversations. Men and women see the facts the same way. But how they feel about the facts is often very different.

**BM:** On the executive side you have quite a few women in prominent positions. There are clearly a lot of female money managers. When I look at Fidelity, Capital Group, T. Rowe Price, whatever, it's pretty unusual still to see women running significant funds, especially on the equity side. It's a little less true, I think, in fixed income. Is that just history, or is there something more to it?

**AJ:** For us, it's gone in waves. You would remember the likes of Beth Terrana and Bettina Doulton, who were some of our most successful fund managers. Right now there isn't a woman who's in that top group of people with tremendous assets and performance, but there's pretty good representation in the investment organization.

**BM:** You have spoken a little bit about blockchain and crypto. What excites you in that area?

**AJ:** One of the things we do to try to get people in the organization thinking about the future and get past just thinking about the next incremental thing is scenario-planning exercises. We get different people from different parts of the organization together in a team to tackle some crazy scenario.

We did a series of these a while ago, and one of them was what would happen to our business if capital markets became completely frictionless. Right after that, about 2010 I think, Bitcoin started getting a little bit of visibility. A few of us were like, "Oh, this is kind of actually what we were just talking about in our crazy scenario plan. Maybe we were onto something."

So a few of us were reading about it and started meeting to get the benefit of our collective thinking. Then that morphed into: How could we apply this in our business? Then we rallied some people around the organization to work on those use cases, and the response rate was actually surprisingly positive.

The one thing fairly early that I think gave us some visibility in that realm was being able to contribute Bitcoin to your charitable gift fund.

That got us connected with a bunch of very successful Bitcoin entrepreneurs who loved the fact that we were a legacy financial services company but still open to doing this and trying to help them the way we would help any investor. A lot of these people were geeky tech entrepreneurs who had come upon all this money, and they wanted to be philanthropic but it actually wasn't very easy to do, and we made it easy for them.

Then a bunch of our adviser clients started calling and asking us if we could help them with their clients who were Bitcoin holders. A lot of that was stimulated by having become part of the ecosystem.

**BM:** Are millennial customers different, or are they just young?

**AJ:** It's probably some of both. They expect a digital experience. They expect it to be really easy. We designed our robo-offering, ▶

**"We're in the midst of a $22 trillion shift in assets to women, because of longevity, because they'll outlive their spouse, because of divorce"**

Fidelity Go, to have six questions, because we decided that was the maximum that they would be willing to tolerate. I think there is more pressure on millennials to think about saving.

**KM:** That's pushing the entire industry to make the whole investment experience easier. They're the first users and then the rest of the world catches up. We design things for millennials and then calibrate to older people.

**BM:** I can remember your father, Abby, was very into computer stuff when people really had only the dimmest idea of what computers were. Do you spend a lot on technology?

**AJ:** Broadly, technology is what makes it possible for us to charge less and offer more service every year, which is basically the trend in the industry. We looked at other very large direct-to-consumer retail digital businesses to say, "If that's their experience in the rest of their personal life, how can we replicate that here?"

There's new technology now at pretty much every level of the stack. We're on a mission, particularly in PI [personal investing] but elsewhere as well, to offer a digital experience for every service capability.

At the other end of the spectrum, our industry is still running on a lot of mainframe and other vintage technology. That is for a good reason. It's very well established, it's very reliable—everybody's very risk-averse on that front for a good reason. We're now entering a world where there are other technologies that potentially could take the place of that.

**BM:** How does Fidelity balance data privacy with trying to create a frictionless experience?

**KM:** First of all, we never sell any data that we get, and we don't allow vendors to—if they work with us—take it for any other purpose either.

We use data in service of the customer. If we know that a customer has certain needs, we should be proactive in asking them about X, Y, or Z based on some life event coming up. Our experience should be better for an individual consumer than your experience on Netflix.

**BM:** Any concern that those other people from those other industries, like the Amazons, Googles, and whatever, will get into your industry à la Ant Financial, say, in China?

**AJ:** Ant operates in a very different regulatory environment than we do. Ant couldn't exist in the U.S., because you can't mix the businesses the way they do. In terms of those other companies, they've certainly been investigating. We know that.

**BM:** We've seen BlackRock and Vanguard start to make a big push in Europe with ETFs. Where do you see the global opportunities?

**AJ:** The U.K.—if you look at the dynamics of the market and the regulatory environment—is actually starting to look and feel more like the U.S. Many corporates there are going down the path of prioritizing defined-contribution plans. In fact, the way the rules are structured there, companies are heavily incented to have defined-contribution plans. The members of those plans are encouraged more strongly into the plans even than they are here in the U.S.

You're seeing robo-advisers in that marketplace. The banks are not as prominent. The regulators have been encouraging more competition and new players to come into the marketplace. It's an interesting place right now. We've got a very strong presence in the U.K. We have a long history [through Fidelity International]. Anthony Bolton, who is as famous in the U.K. as Peter Lynch was here in the U.S., was a fund manager there for many years. He's still a director



Johnson

of the company and maintains a presence around the organization.

There's not really a direct business on the Continent, but we have good relationships with many wholesalers. And ditto in Japan. We've got a strong investment team due to our start in 1969 in Tokyo, and Hong Kong is another place we've been for a long time. It's not a huge market, but, again, we've done reasonably well through wholesalers. It turned out to be valuable, because now we've had an effort to build a presence in China.

We started putting people there, and there are all these little steps you have to go through. We've got a license for our own wholly owned financial services company there.

**BM:** Your father ran the company for decades. What was he like to work for?

**AJ:** Well, he was famous for being a contrarian, and I think that probably rubbed off on me. I'm not afraid to have a different point of view. He was incredibly inquisitive of everybody all the time. From what people tell me, I have a tendency to do the same thing. Whether that's genetic or it comes out of the fact that we were both analysts and fund managers before we became managers, I don't know. I think, for me, having an investment background as he did was really helpful, because your basic mode of operation is to be asking questions and expecting people to help you figure stuff out.

Like everyone else who's been in business for decades and seen a lot, he always had a list of rules of thumb. Things like, "It's easy to be right on the direction of something" and "It's the timing that's hard, so adjust your planning to that."

I feel incredibly grateful for all the years of learning that I had from him. He was a very strategic thinker: If our capabilities are really good here, can we take those same capabilities and use them somewhere else? I've tried to do the same thing.

**BM:** He was not a big "talk to the outside world" kind of guy in his time. In the last year you've talked a little bit more at public forums. Anything spark it?

**AJ:** It's expected as a leader of a company now. We want to get our message out. It's time-consuming, so I think you have to be careful about how you allocate your time. Kathy's been great, and other people as well have taken time to speak in outside forums and make themselves available. We want our customers to understand us.

**BM:** Have there been opportunities that Fidelity has missed by being a private company? BlackRock in 2009 was able to scoop up Barclays' iShares because they were able to use their stock.

**AJ:** Well, you're absolutely right. We're not in a position to do an acquisition like that, and that's part of the life of being a private company. Acquisitions that work out that well are, I would argue, more the exception than the rule. Kudos to those guys for making a great move and making it really work, because it seems like it's been incredibly successful. And, oh, by the way, through our partnership with them we've actually benefited from it as well.

The only one we've done that wasn't tiny was this company called EMoney, a desktop tool for independent advisers, for our intermediary business. This EMoney application is what a lot of advisers like to use in their interactions with their clients, their investors, so it's been a great acquisition for us.

**BM:** Does that make you think about doing another like that?

**AJ:** It's nice to know you can do it. I think there are a few of us here who thought, Let's prove we can do something new. And we went and we did it. The company has grown tremendously since we bought it.

**BM:** I think Fidelity's probably only been run by three people since the beginning, and they've all been named Johnson. Does that have to stay the case, or is that not critical?

**AJ:** I'm still young. I'm not that old. I don't know what's going to happen. It's too early to tell.

**BM:** When you said about half of Fidelity's new hires in branches are women, was that a goal that was set out?

**KM:** It's not a quota. What we wanted to do was increase diversity in general in our branches, really to serve our customers more broadly. We serve millions and millions of women, both through the workplace and through personal investing. There's definitely a confidence gap that women have in investing.

We're in the midst of a $22 trillion shift in assets to women,

Murphy



because of longevity, because they'll outlive their spouse, because of divorce, whatever. Second, and related, 9 out of 10 women will be the sole decision-maker in their household on their finances at some point in their life, either due to the death of the spouse, divorce, or because they stayed single over the course of their career.

If 90 percent of women have to have some understanding of finances and feel confident about it, how can we help women investors get the confidence? We know women are absolutely just as good as men at investing when they actually take the step. We've proven that, and they're actually slightly better. So we've got a major effort in the workplace business as well as in the retail business of helping women feel more confident: educational campaigns, seminars, etc.

You see so many examples of women not feeling confident, not making the moves early. They save, but they don't invest. If you save and just put it in the bank account, and then they wake up and they're 55 and they say, "Oh, my God, what am I going to do?"

**AJ:** We've got a group that's dedicated to studying what those subtle differences and preferences might be and working them back into our program. Kathy runs a very controlled process. Everybody follows the Fidelity program, so we get that information out so it's exercised consistently.

**KM:** For example, we have a policy in our branches of—we don't mandate it, because it's up to the customer ultimately—having both spouses come to planning meetings. Men and women in general learn differently and express their goals differently. Women don't feel confident investing until they know a lot. Men are much more comfortable learning as they go. All the technical terms in financial services—alpha, beta—are a complete turnoff to women. So we've revamped how we talk about financial services.

Men talk about short-term performance, how they're doing lately. Women talk about family goals over a much longer period of time. You have to know these things in order to have the right kind of conversations.

**AJ:** We redesigned our branches so that they would be a little more friendly. Hingham [a branch in Massachusetts] was our prototype for the new design. We had gotten feedback that our branches were too corporate. The same people who did our offices did the branches, so I guess it wasn't that surprising. It's just that no one ever stopped to think about it.

Some of the feedback we got was "get rid of the screens"—the CNBC and the ticker tape. People who are already stock market junkies love that stuff, but it's a real turnoff for people who aren't.

**KM:** We got rid of all desks, and it's all round tables. That's very important symbolically in terms of, "We're not on opposite sides of the table. We're here together." The general design principle was—this holds true in general—if you design things for women, you won't turn off men. If you design things for men, you're more likely to turn off women.

**AJ:** It makes sense. OK, getting a little primal here, men do generally go to where the women are. ●

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