Howard Davies: The Big Tech/Fintech disruption

A new report by the Financial Stability Board argues that Big Tech could "affect the degree of concentration and contestability in financial services, with both potential benefits and risks for financial stability." Managing the risks will require much more than vigilance by banking supervisors, writes Howard Davies

Source: Wikipedia Commons

As its Valentine's Day present to the world, the Financial Stability Board (FSB) in Basel published a report on financial technology, or fintech, and market structure in financial services. The subtitle was more insightful, and revealed the authors' intentions: "market developments and potential financial stability implications."

The report's premise is straightforward. The arrival of established technology giants, or Big Tech, on the financial scene could "affect the degree of concentration and contestability in financial services, with both potential benefits and risks for financial stability."

The focus is on companies like Apple, Google, Facebook, Amazon, and Ant Financial, rather than the myriad fintech startups in Silicon Valley, Israel, or clustered round the Old Street roundabout in London. Central banks and finance ministries are beginning to ask whether the activities of the tech behemoths, whose market capitalizations now dwarf those of even the biggest banks, will be wholly benign.

In a way, it might be thought surprising that the questions are being raised only now. Phrases like "bolting stable doors" come to mind. In Europe, regulatory changes like the Second Payment Services Directive (PSD2) have been crucial in opening up the banking system, and regulators like the United Kingdom's Financial Conduct Authority have for some time been running regulatory sandboxes to smooth the way for new entrants by helping them to structure themselves to comply with standards. PSD2, often described as "open banking," requires banks to offer their customer data to non-bank providers of payment and account information services. Aggregators can then present the customer with an integrated view of their finances, and offer add-on services.

Maybe the time to assess the financial-stability risks of open banking was in the consultation period before the directive was passed. Even now, the list of contributors to the FSB work shows that the European Commission, and the key regulators in Europe and North America, were not involved.

So what did the FSB conclude?

The authors begin, tactfully, with a series of bows to Big Tech. They say, correctly, that "the greater efficiency of new players may enhance the efficiency of financial services in the longer term." Certainly, the absence of the cost drag of legacy IT systems and underused branch networks (which have been seen as a kind of public service and are therefore hard to rationalize) allow for cheaper digital delivery mechanisms which banks can only envy.

It is also entirely fair to argue, as the authors do, that increased competition in the supply of financial services may benefit consumers by expanding choice, stimulating innovation, and driving down transaction costs. The pressure on traditional providers is generating strong incentives to reduce costs and improve service. Incumbents can no longer afford to sit back and allow inertia to be their friend, as they did in the past when account switching was rare. But the FSB also warns that cross-subsidization may allow Big Tech firms to gain market share rapidly and knock out existing providers. As a result, "their participation may not result in a more competitive market over the longer term."

That is a warning policymakers should heed. But the FSB is supposed to be primarily interested in stability. And here the report points in both directions at once. On one hand, the authors argue that greater competition can create a more resilient financial system, with a wider range of companies managing the essential plumbing. On the other hand, the ability of new entrants to undercut banks significantly could make the latter "potentially more vulnerable to losses." The accompanying reduction in "retained earnings as a source of internal capital," the report argues, "could have an impact on financial sector resilience and risk-taking."

The reader is largely left to decide which of these two scenarios is most likely to play out. But while the report is unambiguously positive about the impact of fintech startups, whether they remain standalone entities, or join existing banks to create complementary offerings, the authors' conclusions about Big Tech are far more nuanced. Whereas previous analyses have suggested that the financial-stability implications of fintech are either benign or small, the FSB believes that "this could change quickly with deeper involvement of the large technology providers."

One possible route to financial instability identified in the report is that banks may loosen lending standards unwisely. I would assess that risk as low. Banks have been there before, in recent living memory, and are not keen to go back. But the threat to profitability is real, particularly if "loss-leader" pricing strategies are adopted, as the FSB believes is possible. They refer explicitly to the risk of cross-subsidization. Banks in Europe are not much in favor with investors today, trading well below book value in most cases, and a significant loss of market share in payment services would threaten their viability further.

In response, the FSB, unsurprisingly, argues for "vigilance" on the part of banking supervisors. (When, one wonders, have supervisors been told that now is the time to turn a blind eye?). But I wonder if the answer lies with banking supervisors at all. Had a broader range of authorities contributed to the work, they might have more pertinently recommended vigilance by conduct and competition regulators, too. Following the FSB's own logic, it is in these authorities' territories where the biggest risks are most likely to emerge.

This article was published on Project Syndicate on 20 February 2019

Author

Amrita Naik Nimbalkar
Junior Economist, Global Macro
amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz
Senior Economist, Poland
mateusz.sutowicz@ing.pl

Alissa Lefebre
Economist
alissa.lefebre@ing.com

Deepali Bhargava
Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte
Economist
+32495364780
ruben.dewitte@ing.com

Kinga Havasi
Economic research trainee
kinga.havasi@ing.com

Marten van Garderen
Consumer Economist, Netherlands
marten.van.garderen@ing.com

David Havrlant
Chief Economist, Czech Republic
420 770 321 486
david.havrlant@ing.com

Sander Burgers
Senior Economist, Dutch Housing
sander.burgers@ing.com

Lynn Song
Chief Economist, Greater China
lynn.song@asia.ing.com

Michiel Tukker
Senior European Rates Strategist
michiel.tukker@ing.com

Michal Rubaszek
Senior Economist, Poland
michal.rubaszek@ing.pl

This is a test author

Stefan Posea
Economist, Romania
tiberiu-stefan.posea@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate
jesse.norcross@ing.com

Teise Stellema
Research Assistant, Energy Transition
teise.stellema@ing.com

Diederik Stadig
Sector Economist, TMT & Healthcare
diederik.stadig@ing.com

Diogo Gouveia
Sector Economist
diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Ewa Manthey
Commodities Strategist
ewa.manthey@ing.com

ING Analysts

James Wilson
EM Sovereign Strategist
James.wilson@ing.com

Sophie Smith
Digital Editor
sophie.smith@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Adam Antoniak
Senior Economist, Poland
adam.antoniak@ing.pl

Min Joo Kang
Senior Economist, South Korea and Japan
min.joo.kang@asia.ing.com

Coco Zhang
ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman
Senior Sector Strategist, TMT
jan.frederik.slijkerman@ing.com

Katinka Jongkind
Senior Economist, Services and Leisure
Katinka.Jongkind@ing.com

Marina Le Blanc
Sector Strategist, Financials
Marina.Le.Blanc@ing.com

Samuel Abettan
Junior Economist
samuel.abettan@ing.com

Franziska Biehl
Senior Economist, Germany
Franziska.Marie.Biehl@ing.de

Rebecca Byrne
Senior Editor and Supervisory Analyst
rebecca.byrne@ing.com

Mirjam Bani
Sector Economist, Commercial Real Estate & Public Sector (Netherlands)
mirjam.bani@ing.com

Timothy Rahill
Credit Strategist
timothy.rahill@ing.com

Leszek Kasek
Senior Economist, Poland
leszek.kasek@ing.pl

Oleksiy Soroka, CFA
Senior High Yield Credit Strategist
oleksiy.soroka@ing.com

Antoine Bouvet
Head of European Rates Strategy
antoine.bouvet@ing.com

Jeroen van den Broek
Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma
Senior Sector Economist, Industry and Healthcare
edse.dantuma@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Rico Luman
Senior Sector Economist, Transport and Logistics
Rico.Luman@ing.com

Jurjen Witteveen
Sector Economist
jurjen.witteveen@ing.com

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

Egor Fedorov
Senior Credit Analyst
egor.fedorov@ing.com

Sebastian Franke
Consumer Economist
sebastian.franke@ing.de

Gerben Hieminga
Senior Sector Economist, Energy
gerben.hieminga@ing.com

Nadège Tillier
Head of Corporates Sector Strategy
nadege.tillier@ing.com

Charlotte de Montpellier
Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com

Laura Straeter
Behavioural Scientist

+31(0)611172684
laura.Straeter@ing.com

Valentin Tataru
Chief Economist, Romania
valentin.tataru@ing.com

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Suvi Platerink Kosonen
Senior Sector Strategist, Financials
suvi.platerink-kosonen@ing.com

Thijs Geijer
Senior Sector Economist, Food & Agri
thijs.geijer@ing.com

Maurice van Sante
Senior Economist Construction & Team Lead Sectors
maurice.van.sante@ing.com

Marcel Klok
Senior Economist, Netherlands
marcel.klok@ing.com

Piotr Poplawski
Senior Economist, Poland
piotr.poplawski@ing.pl

Paolo Pizzoli
Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

Marieke Blom
Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering
Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Germany, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

Sophie Freeman
Writer, Group Research
+44 20 7767 6209
Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

James Knightley
Chief International Economist, US
james.knightley@ing.com

Tim Condon
Asia Chief Economist
+65 6232-6020

Martin van Vliet
Senior Interest Rate Strategist
+31 20 563 8801
martin.van.vliet@ing.com

Karol Pogorzelski
Senior Economist, Poland
Karol.Pogorzelski@ing.pl

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

Viraj Patel
Foreign Exchange Strategist
+44 20 7767 6405
viraj.patel@ing.com

Owen Thomas
Global Head of Editorial Content
+44 (0) 207 767 5331
owen.thomas@ing.com

Bert Colijn
Chief Economist, Netherlands
bert.colijn@ing.com

Peter Vanden Houte
Chief Economist, Belgium, Luxembourg, Eurozone
peter.vandenhoute@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM
+1 646 424 6464
gustavo.rangel@ing.com

Carlo Cocuzzo
Economist, Digital Finance
+44 20 7767 5306
carlo.cocuzzo@ing.com