European University Institute

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FLORENCE SCHOOL OF BANKING & FINANCE

Big Tech and Fintech credit

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Online Debate Highlights

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Background

Most recent reports show growing volumes of alternative credit: Fintech credit provided by non-bank digital platforms, and Big Tech credit provided by large technology companies, independently or in partnership with traditional financial institutions. According to a report by the Bank for International Settlements (BIS), the 'total alternative credit' reached USD 795 billion globally in 2019.The expansion of alternative credit has been further accelerated by the Covid-19 pandemic, with more people using financial services and shopping online. As the drastic growth of Fintech and Big Tech credit continues in Asia, Africa and Latin America, should European policy-makers facilitate this innovation-driven change?

The growth of alternative credit is primarily demand-driven, including lower costs compared to traditional banking, ease of use, speed and convenience of Fintech and Big Tech credit. Supply-side factors, in turn, are linked with the stringency of banking regulation, which can create barriers for Fintech and Big Tech credit, but also ease of doing business, and the degree of development of bond and equity markets. Despite the promise of consumer benefits, rapid growth of credit bears the risk of over-indebtedness for individual borrowers and may present risks for financial stability. The debate focused on the risks and benefits of Fintech and Big Tech credit from the European perspective.

The following questions provided the starting point for the debate:

Is alternative credit an opportunity or a concern for the European financial sector?

- Consumer perspective (e.g. choice, consumer protection, privacy)
- Business perspective (e.g. competition, financial stability)

Does the regulatory framework that regulates alternative credit:

- Set barriers for the growth of alternative credit (innovation in finance more broadly)?
- Overlook any risks (to consumer protection, financial stability, competitive process)?

The panel featured

Jon Frost
(Bank for International Settlements)

Philipp Paech
(London School of Economics)

Loriana Pelizzon
(SAFE/Goethe University)

and has been chaired and moderated by

Thorsten Beck
(Cass Business School and Florence School of Banking and Finance, European University Institute)

Key take-aways

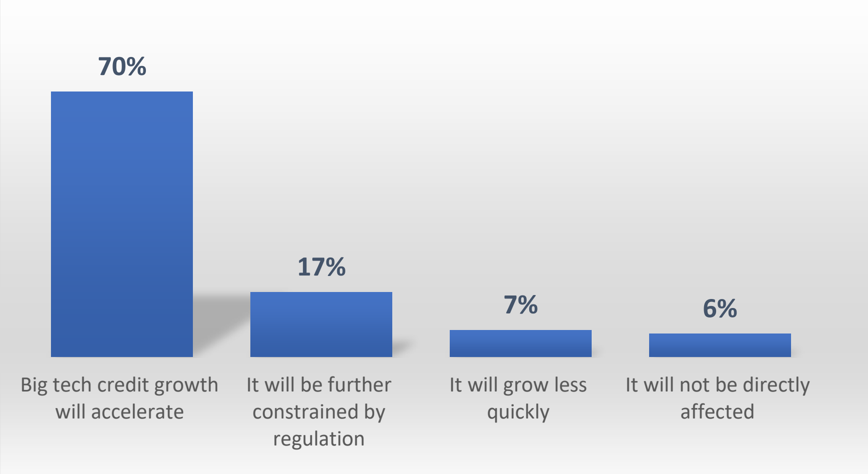
The panellists underlined the key elements of the Big Tech and Fintech credit landscape:

1.
Jon Frost introduced the **key definitions** by reference to the state of the art discussion in the field, that distinguishes between Fintech as 'technology-enabled innovation in financial services' that impacts business models, applications, processes or products; Fintech credit as 'credit activity facilitated by electronic (online) platforms that are not operated by commercial banks'; and Big Tech, defined as 'large companies whose primary activity is digital services, rather than financial services'.

2.
The European market for alternative credit has been characterised by a wider spread of Fintech credit rather than Big Tech credit. Despite the booming numbers of Big Tech credit, it has been underlined that 'whether Big Tech credit will further increase or decrease in the Covid-19 pandemic remains a big question' ***(Frost)***. The market for Big Tech credit in Europe remains relatively small compared to the Asian and the US markets, largely due to 'low returns on equity due to over-banking' ***(Pelizzon)*** and 'less unmet demand for financial services in Europe' ***(Frost)***. According to the polls the majority of the respondents from the audience expected to see the growth of Big Tech credit in Europe to accelerate.

How do you think the Covid-19 pandemic will affect the growth of Big Tech credit in Europe?

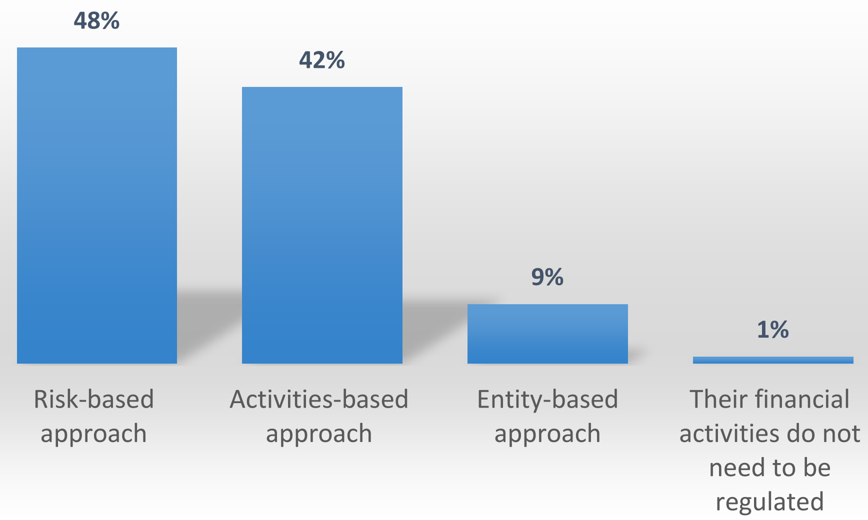
Poll results from the participants
Number of respondents: 130



3.
The regulatory environment for Big Tech and Fintech credit in Europe has been characterised by 'stricter framework' ***(Frost)*** compared to the markets in Asia, the US or other emerging markets. Whilst the global trend sees major jurisdictions 'move towards the entity-based approach' ***(Frost)***, Philipp Paech underlined the importance of risk-based approach ('Same activity, same risk, same rule') in the present realm where 'Big Techs create new and different risks from the ones we knew so far in the financial sector' ***(Paech)***. The participants of the event largely shared the opinion of the speakers.

Should Fintechs and Big Techs providing credit be regulated on the basis of an activities-based, entity-based or risk-based approach?

Poll results from the participants
Number of respondents: 120



The key regulatory and policy challenges that have been emphasised:

4.

The capacity of Big Techs to 'hyper-scalability' *(Frost)* has the potential to have positive impact by improving financial inclusion, but also negative implications for market competition. A 'pro-active instead of reactive regulation' *(Paech)* is needed, such that would incorporate both micro- and macro-prudential requirements, regulation of conduct, use of data (personal and non-personal) as well as consumer protection. One important aspect relates to the shaping of a more pro-active regulatory regime in Europe would face, according to Thorsten Beck, namely: who and at what level (EU or national, or both) could take on the respective regulatory and supervisory task?

5.

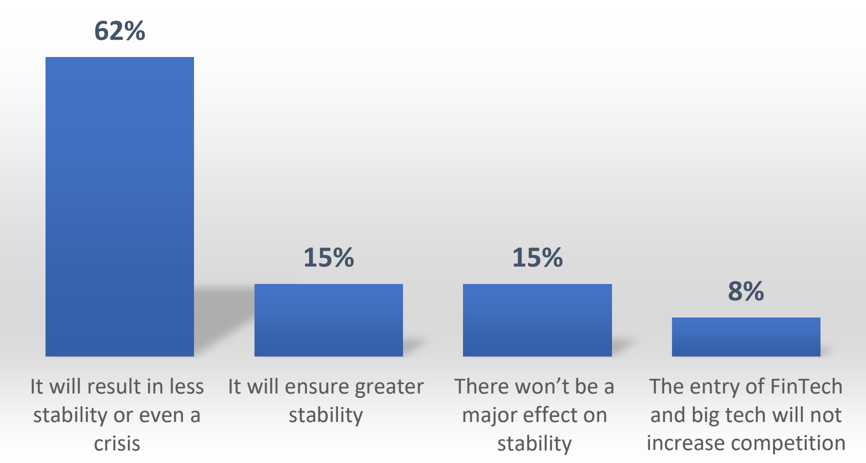
The data-related implications are inseparably linked to Big Tech and constitute a distinct set of regulatory challenges, capable of impacting both the shape of the markets as well as have effect on individual user behaviour. Despite the positive impact of the revised Payment Services Directive (PSD2), 'data sharing framework has to be extended' *(Paech)* and cover both personal and non-personal (inferred) data. '(Data) Interoperability remains a huge issue' *(Frost)* affecting market competition, user switching between service providers and, ultimately, the level playing field and efficiency of the markets.

6.

From the financial stability perspective, one of the key challenges faced by the regulators and policy-makers is the perspective of 'the shift of the financial system from the bank-based to market-based system' *(Pelizzon)*. The Fintech- or Big Tech-dominated system would result in different types of fragility of the system (e.g. bank runs vs market runs, or fire sales). Such change would require a novel policy response in terms of financial stability instruments – 'from the Lender of Last Resort to the Market Maker of Last Resort?' *(Pelizzon)*. According to the polls ran during the event the audience suggested that the enhanced competition from Fintech and Big Tech entrants in the financial system would result in 'less stability or even a crisis', thus sharing the view expressed by the panellists.

What effect will higher financial sector competition due to the entry of Fintech and Big Tech have on financial stability?

Poll results from the participants
Number of respondents: 156



Broader considerations:

7.
Fintech and Big Tech credit appear to have **limited impact on shadow banking**. The alternative credit contributes to both systems: 'Big Tech and Fintech credit is sometimes a form non-bank credit (and thus part of shadow banking / "non-bank financial intermediation") and in other cases in partnership with banks (in which case they are bank credit)' ***(Frost)***. At the moment there is no data as to any effects of new forms of credit on other forms of shadow banking (non-bank credit), which continue to grow.

8.
With respect to **the potential impacts of Brexit**, the panel concluded that despite the need for the UK-based service providers to obtain a separate authorisation (license) from another EU member state to resume their activities in the EU internal market, no new specific risks arise from the operation of Fintech or Big Tech in both markets.

9.
In addition to the necessary policy and regulatory challenges, Big Techs and Fintech players in the financial markets set **new requirements for the skills of regulators**. A clear understanding of the new players is required but, and perhaps most importantly, the regulators need 'people capable of looking at externalities and understanding the impact on the system from the micro level' ***(Paech)***.

You can watch the recording of the Online Seminar on the FBF website and Youtube Channel.

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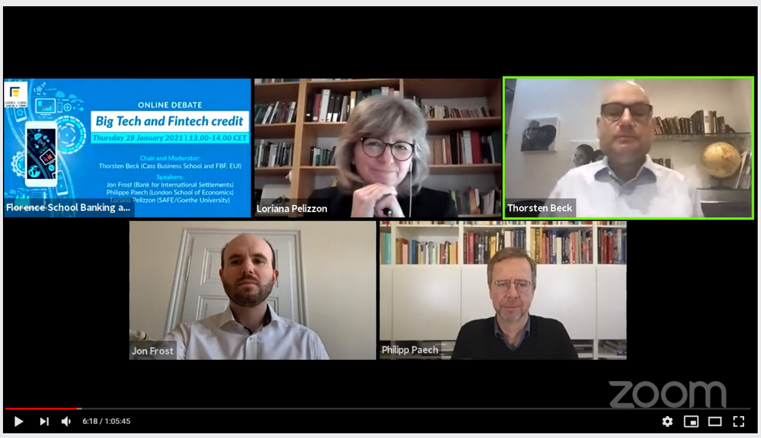

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