

# The Pros and Cons of Big Tech Banking

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**“You can’t look back at the worst financial crisis of our lifetimes that started in 2008 and not have some important lessons about the critical nature of oversights in financial markets and institutions”**

- Austan Goolsbee

**“Move fast and break things”**

- Facebook motto.

The entry of Big Tech players, such as Google, Facebook and Amazon, into online banking is likely to have a significant impact on competition in retail banking. These platforms have many advantages over traditional banks, that can provide them with a competitive edge. Consumers may benefit through better functionality and quality, as well as from innovative financial products and services.

However, within a few years Big Tech companies may succeed in monopolizing the origination and distribution of loans to consumers and SMEs, forcing traditional banks to become “low-cost manufacturers”, which merely fund the loans intermediated by the Big Techs. This may harm competition, reduce consumer welfare and bring about an increase in financial instability.

This risk assessment is not unduly alarmist or exaggerated. The McKinsey Global Banking Review 2018 stated that “investors appear to lack confidence in the future of banks” due “in part to doubts about whether banks can maintain their historical leadership of the financial intermediation system.” In McKinsey’s view, banks are under threat from other financial services firms, non-bank attackers, and technology companies. They risk being “disintermediated from their customers, disaggregated, commoditized and made invisible.” If that risk materializes, only banks “with strong balance sheets, deep access to low-cost funds, and strong financing abilities” may be able to compete effectively.

## Clash of the Titans

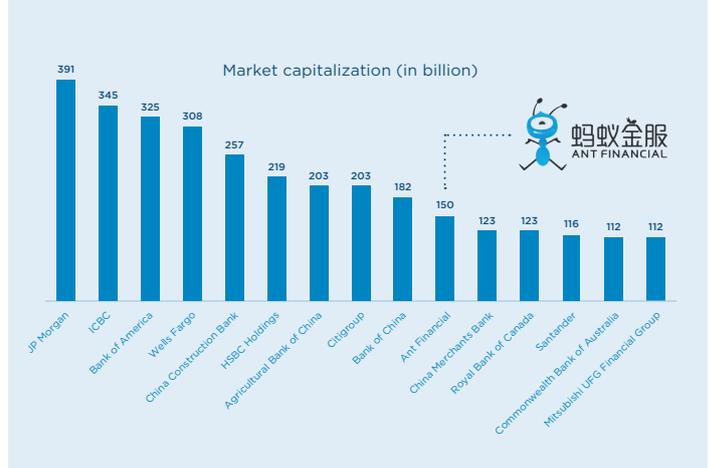
It is in society’s interest that traditional banks find a way to compete with their digital-based competitors. This may prove difficult given the data advantages enjoyed by the Big Tech companies, as well as their ability to cross-subsidise banking operations from profits obtained on tech platforms where they exert market power. Big Tech platforms, free from capital requirements and the other regulations constraining the ability of traditional banks to experiment with new products and business models, could out-invest and thus out-compete

banks. Banks could become dependent on the Big Tech platforms, if they become the “gatekeepers” to markets and consumers.

Whether traditional banks can effectively resist will depend on whether they can ring-fence their loyal and highly profitable customer bases, exploit their informational advantages and reputation regarding data protection, and bundle products with the current accounts of their customers. The outcome will also depend on how regulation treats these new entities in absolute terms, but also in relation to existing banks.

The impact of Big Tech on retail banking has already been felt in Asia. For example, China’s most prominent online commerce company, Alibaba, launched in 1999, started Taobao in 2003 as a consumer e-commerce platform and added Alipay to Taobao in 2004 as a third-party online payment platform. Since then, Alipay (renamed Ant Financial in 2014) has played a vital role in Alibaba’s success and has successfully built its standalone presence with a wide range of financial offerings, including: payments, wealth management, lending, insurance, and credit scoring. Ant Financial’s market capitalisation is now larger than that of Santander, more than half that of Citi or HSBC, and it is growing fast. The safety and soundness of Ant Financial will therefore significantly influence global financial stability.

### Ant Financial now ranks among the world’s most valuable financial services firms<sup>1</sup>



All opinions expressed here are those of the authors, who are employees of Compass Lexecon.

<sup>1</sup> Source: Compass Lexecon, using data from CB Insights Research Brief, October 2018 <https://www.cbinsights.com/research/ant-financial-alipay-fintech/>

## Maintaining competition, maintaining financial stability

Competition authorities should be vigilant to ensure that borrowers are not systematically “steered” towards the Big Tech proprietary services, especially if those services are more expensive and lower quality. They should also be prepared to entertain the possibility that mergers and acquisitions may be needed for banks to achieve the scale needed to remain competitive in the technological race that has just started.

Competition law may not be able to address the risk of monopolization on its own. Other policies should complement the rules of competition (and consumer protection). Banking regulators may need to modify the status quo: reconsidering existing regulatory constraints, particularly those that impact asymmetrically on established banks, and facilitating innovation and business model experimentation by traditional banks, using e.g. “regulatory sandboxes”.

Regulation is crucial, but it is difficult to identify the right approach, as banking business models and their underlying technologies evolve dynamically. The wrong choice may unduly stifle beneficial innovation. Our preferred option is to mandate data sharing. While other alternatives, such as antitrust intervention and privacy regulation, are available and could be useful complements to data sharing, they may prove insufficient on their own.

Banking regulators may also need to consider whether Big Tech firms should be brought into the financial regulation perimeter. At present, Big Tech firms may not be subject to client/customer/investor protection rules that maintain market integrity, nor subject to measures that limit or control the level of interconnectedness between financial intermediaries, thereby preventing the build-up of systemic risk.

For example, fees received by investment firms must not impair compliance with the investment firm’s duty to act honestly, fairly and professionally in accordance with the best interests of its clients. As to predatory lending, financial regulation often imposes fair lending policies, and charges supervisors with enforcing these duties against lenders. However, Big Tech platforms operate outside the perimeter of these regulations or at best there is limited legal certainty as to whether these regulations apply to platforms that rely on, for instance, algorithmic preferencing.

Similarly, Big Tech platforms could generate profits by exploiting their data in ways that would not be open to traditional financial institutions, even if they had access to such data. For instance, the platforms could adjust prices upward for customers insensitive to price or unwilling to switch products and providers. Traditional financial services firms would be prevented from this by their fiduciary duties and financial law requirements to treat customers fairly, honestly and in a non-discriminatory manner.

## If it looks like a bank and acts like a bank...

We believe it is time to consider closing the “regulatory gap” between incumbents and Big Tech entrants. For example, if a Big Tech platform has discretion in selecting potential borrowers or portfolios of borrowers for their clients, then they should be regulated as portfolio managers. And when the platform provides payment services without resorting to a third-party payment service provider, it should be subject to payment service regulation. Finally, if platforms develop secondary markets for their products, and issue tradable and non-tradable securities, they should be subject to security regulation.

Experience shows that regulatory decisions are difficult to reverse and can have a long-lasting impact on an industry when it is young. It is thus important to identify the right regulatory framework to address early the potential adverse impact of the entry of Big Tech platforms on retail financial markets in order to maximise its otherwise positive effect on innovation and competition. If we do nothing, systemic risk may build up unobserved, unmitigated, and uncontrolled.

Without such action, the next global financial crisis may well come from Big Tech platforms rather than authorised financial institutions.