EBA Board of Supervisors’ Away Day

Big tech regulation: in search of a new framework
Based on forthcoming FSI Occasional Paper by Johannes Ehrentraud, Jamie Lloyd Evans, Amelie Monteil and Fernando Restoy

Fernando Restoy, Chair
Prague, 12 July 2022

Views expressed are those of the presenter and do not necessarily reflect those of the BIS.
Outline

1. The issues: business model and risks
2. The current regulatory approaches
3. In search of an appropriate framework
   - The need for an entity-based approach
   - Inspiration from financial conglomerates
   - The limits of current regulatory categories
4. A new regulatory category for big techs
   - Scope of application
   - Regulatory architecture
   - Regulatory requirements
   - Supervisory approach
5. Conclusions
THE ISSUES: business model (1)

- A unique business model leveraging large amounts of clients’ data, cutting-edge technology and strong network externalities.

Source: FSI Insights 44: "Big tech interdependencies – a key policy blind spot", July 2022
THE ISSUES: business model (2)

<table>
<thead>
<tr>
<th>Service offerings by big techs under analysis</th>
<th>Core services</th>
<th>Financial services</th>
<th>Technological services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Big tech</td>
<td>E-commerce</td>
<td>Digital Consumer services</td>
<td>Banking</td>
</tr>
<tr>
<td>Alibaba (Ant Group)</td>
<td>✔️</td>
<td>✔️</td>
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<tr>
<td>Amazon</td>
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<tr>
<td>Grab</td>
<td>✔️</td>
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<td>✔️</td>
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<tr>
<td>Jumia</td>
<td>✔️</td>
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<td>✔️</td>
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<tr>
<td>Mercado Libre</td>
<td>✔️</td>
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<td>Rakuten</td>
<td>✔️</td>
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<td>✔️</td>
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</tbody>
</table>

✓ Provision of financial service through big tech entity and/or in partnership with financial institutions outside big tech group in at least one jurisdiction.

# Social networks, mobility, deliveries and media services.

% The main activity of an entity engaged in banking is taking deposits, though regulations vary across countries.

* This includes both cloud-storage and cloud computing solutions.

& Other technological services include, for example, telecommunication services, navigation services, digital workplace services.

Sources: BIS (2019); Citi GPS (2018); FSB (2019); IBFED and Oliver Wyman (2020); Van der Spek and Phiffcr (2020); public sources; FSI.

➢ Wide variety of (interconnected) commercial and financial activities (Crisanto et al, FSI (2022)).
THE ISSUES: business model (3)

Recent big tech initiatives in financial services

- **Legend**
  - Payments-related initiatives
  - Lending-related initiatives
  - Crypto-related initiatives

- **Facebook (Meta)** created the Libra Association
- **2019**
  - **Alibaba** buys UK payments firm WorldFirst

- **2020**
  - **Apple** buys payments firm Mobeewave
  - **Amazon** partners with American Express to launch Amazon Card

- **2021**
  - **Google** partners with Citi and Stanford Federal Credit Union to launch Google Flex
  - **Amazon** partners with ING and Goldman Sachs in SME lending

- **2022**
  - **Instagram (Meta)** announced the integration of NFTs from Ethereum, Polygon, Solana and Flow
  - **Mercado Libre** invested in 2TM, parent company of digital assets exchange MercadoBitcoin.com.br, and in Paxos, regulated blockchain infrastructure platform
  - **Apple** buys UK Open Banking company Credit Kudos
  - **Google and Alibaba** applied for a ‘crypto license’ with MAS
  - **Alibaba** authorized NFTs exchanges on its platform
  - **MetaMask**, a cryptocurrency wallet, integrated **Apple Pay**
  - **Apple** launched its BNPL service


- **Continued increase in financial activities**
THE ISSUES: risks for financial stability

- From provision of financial services
  - Interdependencies and conflicts between financial and non-financial activities
  - Opaque partnerships with financial institutions
  - Participation in potentially disruptive digital money-related activities

- From provision of tech services to financial institutions
  - Critical role for operational resilience of financial sector
  - Systemic implications due to few providers

- From concentration dynamics
  - Impact on market contestability and tendency towards market dominance
  - Increased vulnerability of the financial system through excessive concentration
CURRENT REGULATORY APPROACHES

- Mostly a piecemeal approach
  - Developments in different policy domains
  - Focus on regulated financial subsidiaries (regulated on basis of sectoral regimes)
  - No true “group-wide” requirements
  - Few controls for interaction across legal entities

- Emerging regulation for some specific activities
  - Issuance and provision of services related to stablecoins
  - Provision of critical services to financial institutions (eg cloud)

- Emerging entity-based regulation in the area of competition
IN SEARCH OF A NEW FRAMEWORK: the need for entity-based rules

- Target interaction across all big tech activities (Restoy (2021), Carstens et al (2021))
- For financial activities, choose between: (i) restriction; (ii) segregation; and (iii) consolidation

![Diagram showing the advantages and drawbacks of Restriction, Segregation, and Consolidation]

Strong case to consider “group-wide” regulation

IN SEARCH OF A NEW FRAMEWORK: inspiration from conglomerates

<table>
<thead>
<tr>
<th>Comparison of the current regulatory regimes</th>
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<tbody>
<tr>
<td></td>
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<tr>
<td><strong>Scope</strong></td>
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<tr>
<td>Required subsidiaries to fall within scope</td>
</tr>
<tr>
<td>Bank</td>
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<tr>
<td>Bank and insurance</td>
</tr>
<tr>
<td>Other</td>
</tr>
<tr>
<td>Thresholds</td>
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<tr>
<td>Size</td>
</tr>
<tr>
<td>NFA1</td>
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<tr>
<td><strong>Licensing and supervision</strong></td>
</tr>
<tr>
<td>Licensing</td>
</tr>
<tr>
<td>Consolidated supervisor</td>
</tr>
<tr>
<td><strong>Requirements</strong></td>
</tr>
<tr>
<td>Consolidated prudential requirements</td>
</tr>
<tr>
<td>Intragroup financial transactions</td>
</tr>
<tr>
<td>Non-financial intragroup interdependencies (data, IT systems)</td>
</tr>
<tr>
<td>Conduct of business (competition)</td>
</tr>
</tbody>
</table>

Sources: Trial Measures, FHC, FICOD, CRIL.

IN SEARCH OF A NEW FRAMEWORK: limits of current regulatory categories

- Focus on traditional financial activities (banks, insurance)
- Emphasis on prudential requirements
- Lack of sufficient controls over interaction between:
  - Non-financial activities (eg e-commerce)
  - Regulated financial activities (eg payments, deposit-taking)
  - Unregulated financial activities (eg lending, credit-scoring)
A NEW REGULATORY FRAMEWORK

The main elements of big tech financial group (BTFG) regulation

- Scope of application. What are “significant” financial activities?

- Regulatory architecture
  - Organisational structure
  - Home-host issues

- Actual group-wide requirements
  - Governance
  - Conduct of business (data, competitive behaviour, ethics)
  - Operational resilience
  - [Financial soundness]

- Supervisory regime
A NEW REGULATORY CATEGORY FOR BIG TECHS: regulatory architecture

Source: Authors’ conceptualisation.

(*) A FHC that groups together subsidiaries in a single jurisdiction would be regulated by the host authority. If such country-level FHCs are parented by a global FHC, this entity would be regulated by the home authority.
# A NEW REGULATORY CATEGORY FOR BIG TECHS: group-wide requirements

## Regulatory requirements for BTFGs

<table>
<thead>
<tr>
<th>Governance</th>
<th>Conduct</th>
<th>Operational resilience</th>
<th>Financial soundness</th>
</tr>
</thead>
<tbody>
<tr>
<td>Group-wide corporate governance standards:</td>
<td>Group-wide conduct of business standards:</td>
<td>Group-wide operational resilience standards</td>
<td>Group-wide prudential requirements</td>
</tr>
<tr>
<td>• Suitability of board members and senior management</td>
<td>• Collection and use of client and user data</td>
<td>• Mapping of intragroup interdependencies</td>
<td>• Capital requirements</td>
</tr>
<tr>
<td>• Constraints on overlapping boards within BTFG</td>
<td>• Sharing of data within group and external parties</td>
<td>• Interdependencies between services offered to financial institutions and other big tech activities</td>
<td>• Liquidity requirements</td>
</tr>
<tr>
<td>• Transparency of organisational structure</td>
<td>• Anticompetitive practices (ex ante rules)</td>
<td>• Business continuity planning and testing</td>
<td>• Group-wide capital and liquidity planning</td>
</tr>
<tr>
<td>• Policies to identify conflicts of interest</td>
<td>• Unethical, illegal or discriminatory misuse of platform</td>
<td>• Disclosure to supervisors</td>
<td>• Management of group-wide concentration risks and significant intra-group transactions</td>
</tr>
<tr>
<td>• Risk management culture</td>
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<td></td>
<td></td>
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<tr>
<td>• Internal interdependencies</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>• Pricing policy for intragroup transactions</td>
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</tbody>
</table>

Requirements apply to all BTFGs.

Requirements apply only to BTFGs that fall under existing financial-group categories (e.g., FHC or MFHC).

A NEW REGULATORY CATEGORY FOR BIG TECHS: supervisory approach

- Strong case for a single supervisor of group-wide requirements

- ...closely coordinated – via MoUs – with relevant non-financial regulators (data, competition.)

- ...and leading a “college” with sectoral supervisors of relevant financial subsidiaries (including local FHCs)
CONCLUSION

- Clear case to develop a specific regulatory category for big techs with significant financial activities (BTFGs)
  - Scope should weigh specificity and flexibility
  - Group-wide requirements should complement sectoral regulations and be consistent with jurisdictional responsibilities
    - Emphasis on governance, conduct of business and operational resilience.
    - Prudential (eg capital/liquidity) requirements only when BTFGs fall under existing “conglomerate-type” categories
  - Grouping all financial activities under FHC would facilitate oversight and allow for more practical and effective compliance with established rules
  - Integrated supervision of group-wide requirements, supported by MoUs and supervisory colleges, including other domestic and foreign authorities
- Clear need for international standards