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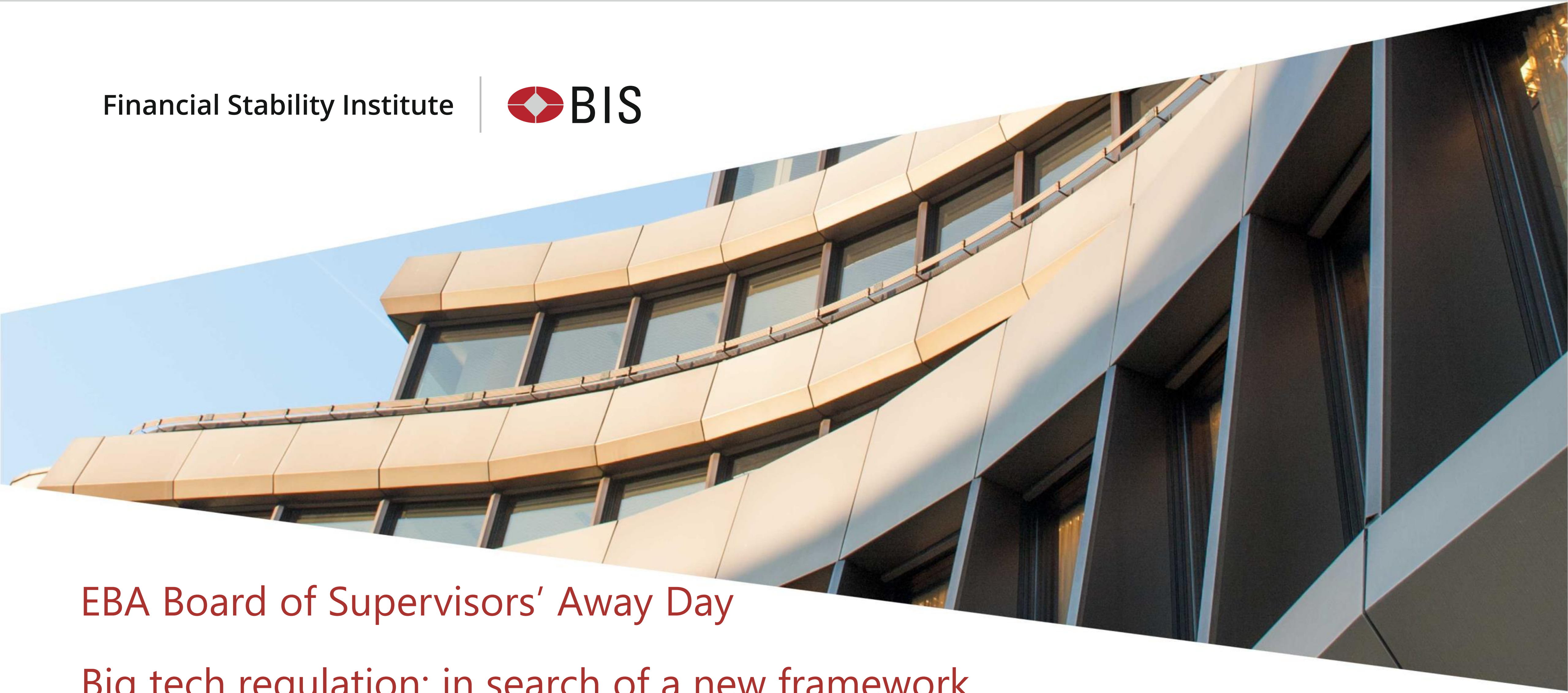


EBA Board of Supervisors' Away Day

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

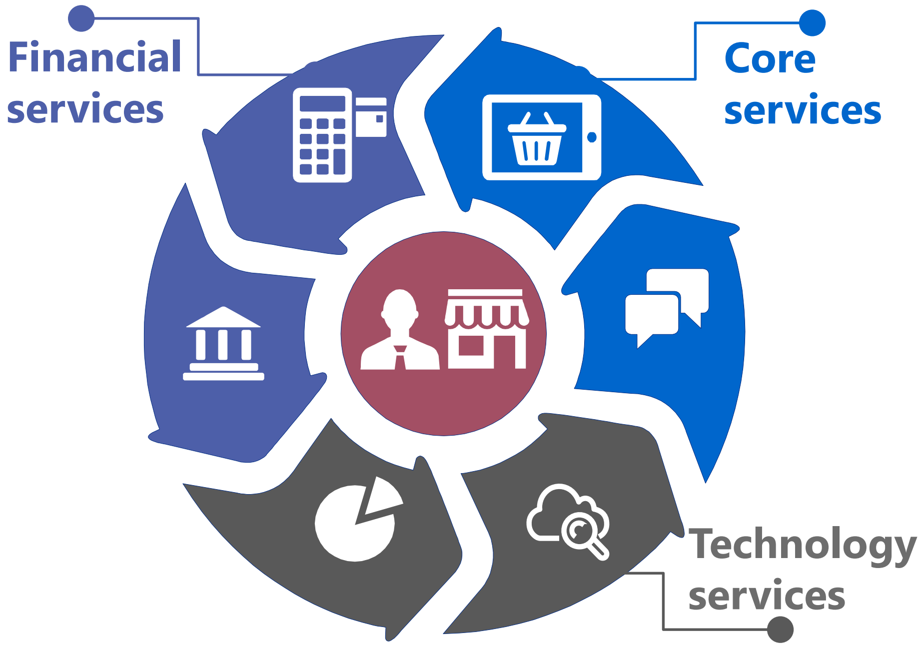
Prague, 12 July 2022

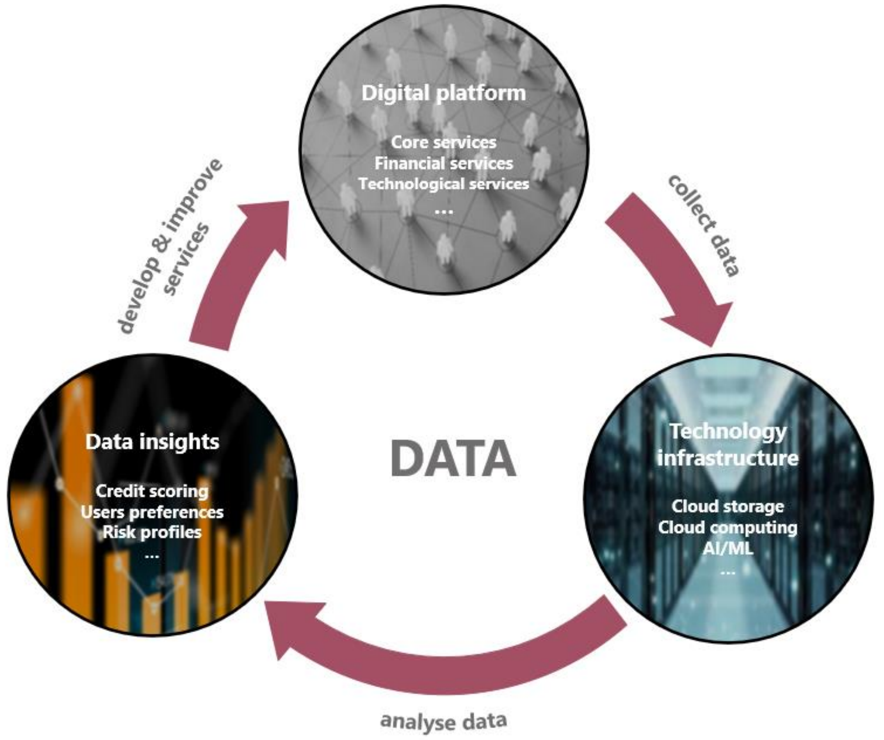
Views expressed are those of the presenter and do not necessarily reflect those of the BIS.

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)





Source: FSI Insights 44: "Big tech interdependencies – a key policy blind spot", July 2022

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

THE ISSUES: business model (2)

Service offerings by big techs under analysis

	Core services		Financial services					Technological services		
Big tech	E-commerce	Digital Consumer services#	Banking%	Credit provision	Payments	Asset management	Insurance	Cloud-based solutions*	Data analytics	Other&
Alibaba (Ant Group)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Amazon	✓	✓		✓	✓		✓	✓	✓	✓
Grab		✓	✓	✓	✓	✓	✓		✓	
Jumia	✓	✓		✓	✓					
Mercado Libre	✓		✓	✓	✓	✓				
Rakuten	✓	✓	✓	✓	✓	✓	✓		✓	✓

✓ 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.

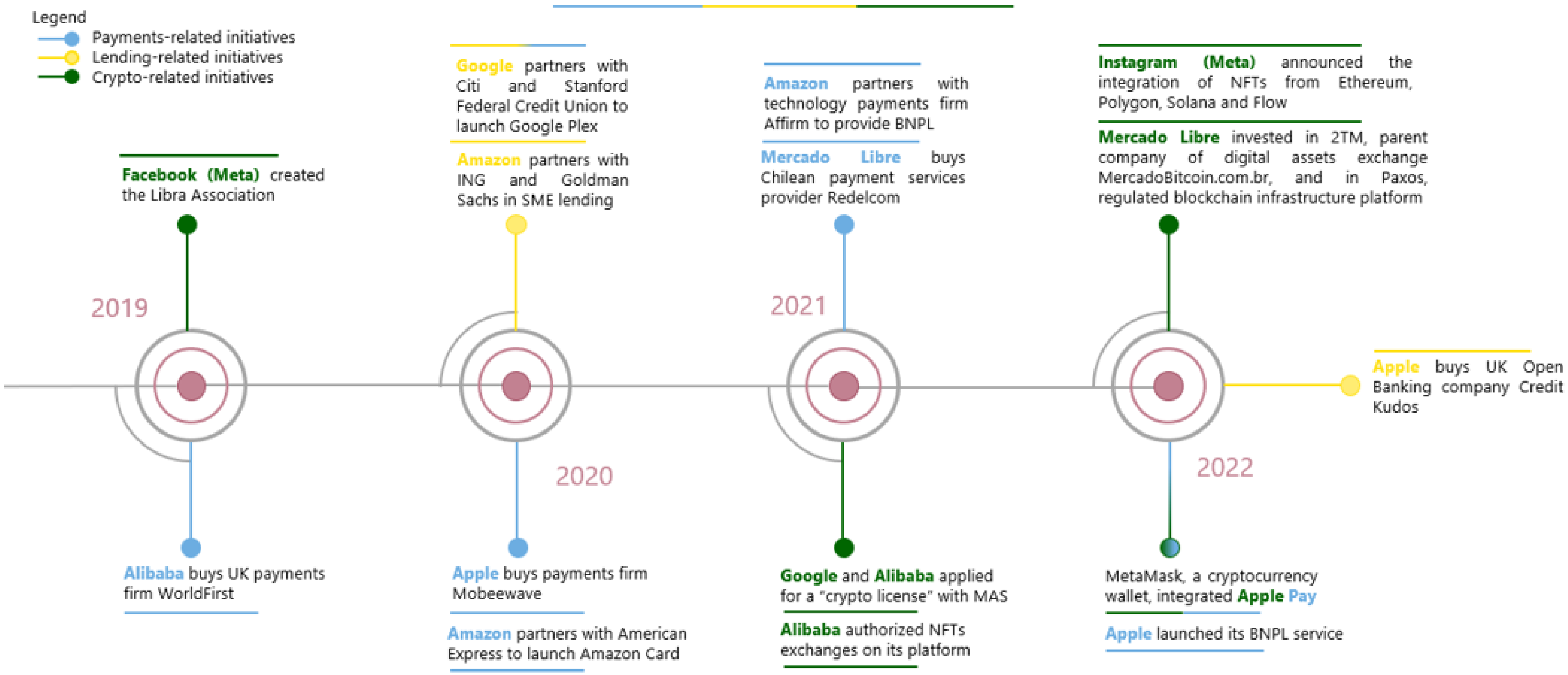
& Other technological services include, for example, telecommunication services, navigation services, digital workplace services.

Sources: BIS (2019); Citi GPS (2018); FSB (2019); IBFED and Oliver Wyman (2020); Van der Spek and Phijffer (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



Source: *FSI Occasional Paper*, forthcoming.

- ➢ 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

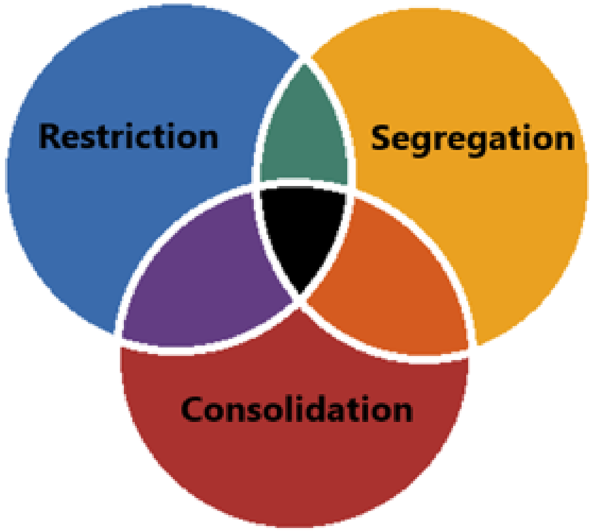
- Mostly a piecemeal approach
  - Developments in different policy domains
  - Focus on regulated financial subsidiaries (regulated on basis of sectoral regimes)
  - No true "group-wide" requirements
  - Few controls for interaction across legal entities

- 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



	Restriction (■)	Segregation (■)	Consolidation(■)
Advantages	• Simple to implement • Risks more clearly identified and managed	• Sheltering of financial activities from non-financial risks • Transparency	• Comprehensive group-wide approach • Competitive and inclusive markets
Drawbacks	• May impede innovation • Potential to reduce competition	• Group-wide risks may be under-appreciated	• Business model and supervisory complexity • May lead to disproportionate regulatory burden

Source: *FSI Occasional Paper*, forthcoming.

- Strong case to consider "group-wide" regulation

IN SEARCH OF A NEW FRAMEWORK: inspiration from conglomerates

Comparison of the current regulatory regimes

			FHC (China)	FHC (US)	FHC (EU)	FICO (EU)	MFHC (EU)
Scope	Required subsidiaries to fall within scope	Bank		✓	✓[ii]		
		Bank and insurance				✓	✓
		Other	✓[iii]				
	Thresholds	Size	✓[iv]			✓[v]	✓
		NFA[i]	✓	✓	✓	✓	✓
Licensing and supervision	Licensing		✓	✓	✓		✓
	Consolidated supervisor		✓	✓	✓	✓	✓
Requirements	Consolidated prudential requirements		✓	✓	✓	✓	✓
	Intragroup financial transactions		✓[vi]	✓	✓	✓	✓
	Non-financial intragroup interdependencies (data, IT systems)		✓[vii]				
	Conduct of business (competition)		✓[viii]	✓[ix]			

Sources: Trial Measures, FHC, FICOD, CRR.

- Interaction across financial activities already regulated (Noble (2020), ESA (2022))

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

- Focus on traditional financial activities (banks, insurance)

- Emphasis on prudential requirements

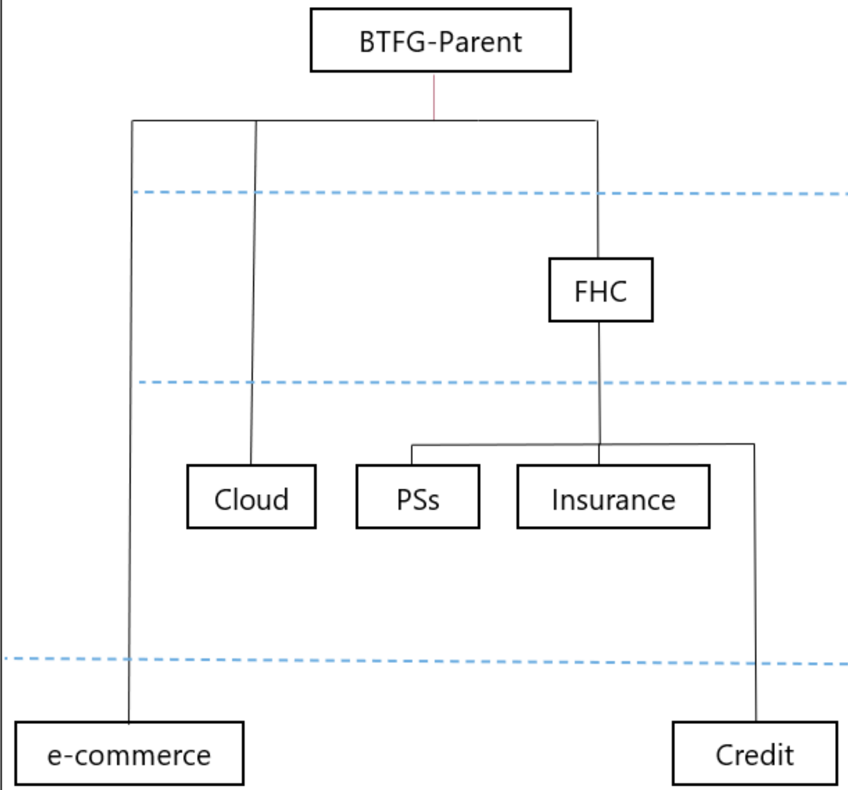
- Lack of sufficient controls over interaction between:
  - Non-financial activities (eg e-commerce)
  - Regulated financial activities (eg payments, deposit-taking)
  - Unregulated financial activities (eg lending, credit-scoring)

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



Regulation	Jurisdiction
Group-wide: - Governance - Conduct - Resilience - (Prudential)	Home
Consolidated: - Prudential	Home/host#
Sectoral: - Governance - Conduct - Resilience - (AML/CFT) - (Prudential)	Host
Unregulated: - No licensing requirement - General obligations: data privacy, competition, consumer protection etc	Host

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

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

(blue)	Requirements apply to all BTFGs.
(red)	Requirements apply only to BTFGs that fall under existing financial-group categories (eg FHC or MFHC).

Source: *FSI Occasional Paper*, forthcoming.

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