Sabine Lautenschläger: Digital na(t)ive? Fintechs and the future of banking

Statement by Ms Sabine Lautenschläger, Member of the Executive Board of the European Central Bank and Vice-Chair of the Supervisory Board of the Single Supervisory Mechanism, at an ECB Fintech Workshop, Frankfurt am Main, 27 March 2017.

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We will never know who did it and when exactly it was done – all of that is lost in the mists of time. But about 4,000 years ago, one of our ancestors invented the wheel. It was one of the most important inventions in the entire history of humanity. Ever since, our lives have been shaped by innovations.

Some of these innovations have made our life better – just think of vaccines or the telephone. Others have had more ambivalent impact – think of nuclear power. In any case, it is always hard to guess where an innovation will take us. And it is all too easy to get it wrong.

As the President of IBM said in 1943: "I think there is a world market for maybe five computers." He got it wrong, it seems. And so did Robert Metcalfe in 1995. As the founder of a tech company, he predicted that "the internet will soon go spectacularly supernova and in 1996 catastrophically collapse."

The internet did not collapse. Instead, it has changed our lives. Could you live without the internet? Could you live without a mobile phone? Our entire life has become digital, and this includes the way we do banking. Fintech, as it is known, seems to be the next big thing.

It's true that, in continental Europe, fintechs still account for just a small share of the markets for banking, payment services and asset management. Still, over the past years, they have received a lot of attention and a lot of funds. Fintechs are on the rise. They have entered the markets, and they are competing with banks – at least in some parts of the value chain.

The question is: where will this innovation take us? Is it the end of banking as we know it? Will it create new risks? As I said before, it is hard to guess how innovations will evolve and easy to get it wrong. That said, let us take a very brief look at some potential futures.

Scenario one: banks might embrace the digital trend and team up with fintechs. For banks this would be one of the more benign outcomes. And it seems to be happening right now.

Scenario two: fintechs might break up the value chain of banking. Banks would end up losing revenue, market share and direct contact with clients. The result might be a more fragmented market where some players operate outside the scope of regulation and supervision.

Scenario three: banks might still end up being crowded out. At the same time, however, the fintechs could be swallowed up by big tech companies, such as Google, Amazon and Facebook. The market would become more concentrated, less competitive and less diversified.

Whichever direction we are headed, there is one thing we supervisors worry about: increasing or unidentified risk. And there are indeed some risks that have become more apparent now that fintechs have entered the scene.

A basic truth is that new players make the market more competitive. And that could squeeze profits and force banks to cut costs in areas such as risk management. This is a general concern we have.

At the same time, bank funding might become less stable. New products, tools and services enable depositors to easily and quickly switch banks; they can select a better offer in a heartbeat. For banks, deposits might become a less reliable and more costly source of funding.

With regard to lending, we are also seeing new trends such as peer-to-peer lending and crowdfunding. Here, savers and borrowers interact directly – banks no longer serve as middlemen. As these new businesses grow, risks associated with traditional banking might emerge – just think of the risks from maturity and liquidity transformation. Some peer-to-peer lenders are already securitising the loans they originate from their platforms. Regulators will need to deal with the resulting vulnerabilities. The work on shadow banking done by the Financial Stability Board and the Basel Committee on Banking Supervision might serve as a basis.

Some fintechs also apply new models for scoring the quality of loans. These models are based on vast amounts of data and are supposed to be more precise than traditional approaches. But they have hardly ever been tested in a severe recession or a crisis. So we don't know how well they would work in such situations.

In respect of asset management, new products such as robo-advice are now appearing. These are computer programmes that advise customers on how to invest their money. Depending on their design, they might lead many investors to take the same positions at the same time. Such herding could then enforce current trends, creating bubbles or bursting them.

And then there are threats of a more technical kind: cyber risks. Cyber risks affect everyone – banks, fintechs and their customers. Arguably, fintechs are more exposed to cyberattacks and data theft. Their IT platforms are small and interconnected, and they often use public cloud solutions and outsource data storage. That said, fintechs are digital natives and are very aware of the risks.

Ladies and gentlemen, it is hard to predict where the fintech journey will take us. It is obvious, however, that the train has left the station and is speeding up. Customers want to extend their digital life to banking; they want banking services anytime and anywhere. Those who can satisfy their needs will become dominant players.

There is a chance that fintechs will deeply transform the banking business. It is up to regulators and supervisors to ensure that this does not come at the cost of stability. The issue is, of course, that fintechs often operate outside the regulated banking sector. With that in mind, policymakers should follow the general principle of "same business, same risks, same rules". That is important.

As banking supervisors, we focus on risks related to banks. In that regard, we are working on a number of projects.

- Take bank licences, for example. We see a rising number of applications related to fintechs. In response to this, we have teamed up with the national supervisors to work on a joint policy approach. It will ensure that applications are treated in the same manner across the entire euro area. Risks that are specific to fintechs will be assessed appropriately and proportionately.
- We are also seeing more and more supervisors exploring and setting up mechanisms to facilitate the authorisation process for fintech banks. Innovation hubs and sandboxes are two of the key words here. And we too are seeking to implement a euro area-wide hub for fintechs.
- We are also assessing the risks that might arise when banks or fintechs outsource data or even entire IT systems. We already carried out some work in this regard; in 2015, we did a cybercrime survey, which was a unique project at the global level. As a follow-up we implemented a data base to track and analyse cyber incidents in large euro area banks.
- And last but not least, concerning the business models of banks, we will explore potential

risks that emanate from fintechs and other non-bank competitors. In that regard, fintechs are among our supervisory priorities.

We have to closely monitor how fintech evolves and better understand its impact. Our workshop today serves that goal. It brings together fintechs, banks and supervisors, and it allows us all to share our ideas and experience. It helps us to shape our supervisory views and limit potential risks. And it helps the financial industry to provide modern and safe financial products. Such exchanges are vital.

I therefore thank all those who are contributing to this event and all those who made it possible in the first place!

Thank you for your attention.