Burkhard Balz: Fintech and bigtech firms and central banks – conflicting interests or a common mission?

Speech Mr Burkhard Balz, Member of the Executive Board of the Deutsche Bundesbank, at the German Embassy, Singapore, 11 November 2019.

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1 Introduction

Ladies and gentlemen,

Your Excellency Ambassador Dr Sante,

I am delighted to have the opportunity to speak to you here today at the German Embassy. It was in 1965 that the German Embassy in Singapore was opened. However, German-Singapore relations extend much further back into the past.

As early as 1856, seven German merchants came together and founded the Teutonia Club on North Bridge Road, not even a 30-minute walk from here. Back then, people would meet up there to sing German songs together. We can quite happily do that today, too – perhaps a little later on in the evening – but my speech, in any case, focuses on the future of payments in Germany and Singapore.

Discussing the topic of payments has never been more exciting than it is now. In recent years, emphasis has increasingly been put on payments again as they are the "gateway" to stable customer relations for the banking industry.

We are witnessing intense competition but also cooperation between banks, bigtech firms and fintech players. At the same time, there is a wealth of innovations and new technologies that could be applied in payments.

From blockchain through real-time payments to using artificial intelligence, we are experiencing a large number of changes that have altered the way we pay – and will continue to do so.

2 Fintech landscape in Germany

These developments have an impact on the market structure by lowering the traditionally high market entry barriers for new competitors. At the back end, for example, cloud computing can help to quickly and flexibly build up and reduce computing capacity with low fixed costs, and without taking the IT system landscape that has evolved over time into consideration at all.

This landscape is viewed increasingly as a "burden" and less and less as a strategic asset, particularly by established players, due to its complexities. At the front end, smartphones ensure that companies are able to make their solutions available to a large number of users in a short space of time.

Costs could be reduced here, too, as there is no need to maintain a cost-intensive branch network. Moreover, these solutions are in keeping with the new digital age in terms of customer convenience.

It is often young companies that use these technologies intensively. In the financial sector, we call these innovative start-ups fintech firms. There are now several hundred of them in Germany. After initially focusing on the front end and the interface between customer and bank, their provision of services has become broader in the meantime. There are now also fintech companies which focus their attention on business-to-business operations.

In Germany we sometimes forget that success and failure are two sides of the same coin. It is therefore not surprising that some new companies have already ceased their business activities.

One such example is the person-to-person (P2P) payments market. This entails, for instance, being able to send a payment quickly and easily to your email address or mobile phone number using my smartphone. In Germany, some fintech providers in this area had to withdraw from the market when banks and credit institutions took off their gloves and created their own range of services. Nevertheless, something good came about from this: the companies ensured that banks became even more customer oriented, and now banks' P2P services are being used intensively.

The current consolidation period is part of the process of the market maturing. This "coming of age" of the market is evident when looking at investments and the way in which they are made. A surge in investments was seen in Germany in the first half of the year. In the first quarter alone, almost €700 million was invested in start-ups in the financial sector. Compared with the final quarter of 2018, this constituted an increase of almost 80% and a new quarterly record.[1] These investments are, however, no longer being broadly diversified; instead they focus on a few large rounds of financing.

Another sign of the maturity of the market is the increasing number of cooperative ventures between fintech companies and existing players. The cooperation between fintech firms and banks offers both parties major advantages: thanks to the new companies, banks are able to present themselves in a more agile and digital way.

"Regtech" players can, for instance, help credit institutions and other financial market agents make their regulatory reporting systems more efficient by using automation potential for regulatory issues. Moreover, innovative solutions based on artificial intelligence are already being implemented to detect cases of fraud and in the automation of processes. There are also high hopes that artificial intelligence can help use credit institutions' "wealth of data" more effectively – that is, in a way that guarantees complete data sovereignty.

Fintech players can, in turn, benefit from expertise and from banks' customer base. Given that finances are a matter of trust, it can be difficult for new players to establish themselves in the market on their own.

There are also interesting solutions for us as a regulator: supervisory technology firms – suptech firms for short – can support central banks and supervisory authorities in the digitalisation of supervision and oversight. Tremendous potential is waiting to be harnessed here, particularly in data collection and analysis.[2]

3 Bigtech players: partners or competitors?

As you see, there are many opportunities to create innovative products for financial service providers and end customers. And it probably has never been as important as it is today for traditional players to appear flexible in the financial industry, considering that for some time now, new companies have been surging their way into the payments business. With their large customer base, technological expertise and vast financial resources, bigtech firms are serious competitors for banks.

Some still say that fintech companies will enter the financial market soon. But the reality is that they are already there. For example, I can now pay in shops, do online shopping and in some cases even take out loans using bigtech solutions. PayPal already offers a solution with which online purchases can be paid for at a later date thanks to a loan from PayPal. Apple is the first of these companies to have introduced their own credit card (even though it is still in cooperation with a bank).

In doing so, these firms are also using another of their advantages: their global reach and huge customer base. We admit that being able to use familiar procedures all over the world gives us a certain sense of security. Globally operating brands, such as ApplePay, GooglePay and PayPal, are one step ahead here.

But what risks arise from the increasing importance of bigtech players in the world of payments?

First, bigtech companies are usually platforms that strive to reach large closed ecosystems. This becomes especially clear if you look at the range of the services offered by Chinese bigtech firms. You can pay in shops and simultaneously do online shopping and book your next trip using WeChat and Alipay.

I don’t want to be misunderstood here: models like these are not a bad thing per se, as they are convenient and useful from a customer perspective. Otherwise, they wouldn’t be so successful. Yet once customers become “trapped” in one of these ecosystems, they will be reluctant to change to a different ecosystem.

Everyone who has tried to switch from an Apple device to an Android knows what I’m talking about. Thus, the risk of a monopoly developing increases, with a small number of platforms determining the content and offers that their users get to see.

Second, customers are often given the impression that the services provided don’t cost them anything. And yet customers pay with the raw material that is most important to bigtech firms: data. And if you cover as many areas as the large technology companies do, then you can obtain large quantities of high-quality data. This, in turn, means that individually tailored products can be offered to the consumer. At first glance this seems like a good thing, but there is the risk that consumers will lose sight of other alternatives and the appeal of other fee-based business models will then be reduced considerably.

Third, by dominating the customer interface, there is a risk that banks will lose contact with end customers and become interchangeable payment settlement providers in the background. Here, I can already see issues of financial stability and competition being affected, for the danger exists that the established business models of existing market participants will come under pressure as a result. I would like to emphasise here that it’s not our job to simply cement the existing structures; we are interested in structures that ensure efficient and secure payments. And, for me, this also includes banks.

They therefore need to keep their strengths in mind: their contact with customers and the trust that has been built up between them. At the same time, a partnership with fintech players can help overcome the challenges of digitalisation and fulfil customers’ needs in a targeted manner. However, cooperative ventures with one another can be a further promising approach.

This cooperation between banks is becoming increasingly important and – if I may say so at this point – this must be enabled by competition law. Thus, we expressly welcome the current initiative to create a European solution, since credit institutions in Europe can only survive in the market with their payment services if they, the European banking community, provide customers with their own attractive solution. And the European market as a whole is attractive to banks: after all, it has one and a half times as many inhabitants as the United States.

Another new aspect is that bigtech players have been extending their provision of services beyond pure payment services for some time now. As central banks, we also have to face the competition: with Libra, Facebook plans to introduce a product into the market that could call our role into question.

We intentionally do not refer to Libra as a currency since in Germany, as in the euro area, the only currency in the meaning of legal tender is the euro. By contrast, as I understand it, Libra is a “stable coin” which is pegged to a currency basket and backed by suitable collateral. It therefore requires stable state monetary systems. At the moment, however, the Facebook token still raises too many questions that are yet to be answered. What exactly will the technology be like? What rights and obligations do users and members have? How can money laundering and the financing of terrorism be tackled effectively? And that is only a small selection from my list of questions.

4 Consequences for central banks and regulators

As central banks, we are fundamentally open to innovation. And that is particularly true here in Asia, perhaps even more so than in Europe with its, in some respects, slightly more conservative set-up. But we must also ensure that the security and efficiency of payments continue to be guaranteed. In the case of Libra, it is therefore essential that these unanswered questions are clarified and legal certainty is established. It might also be necessary to adjust the existing legal framework. One thing is clear to me: a means of payment that wants to be used globally, can be used by billions of people and will be integrated into a complex overall system with many participants must comply with high – very high – regulatory standards. This isn’t an attempt to nip such phenomena in the bud; it is quite simply a necessity.

After all, we still follow the principle: “same business, same risk, comparable regulation”. This ensures that no company is given preferential treatment or is disadvantaged, neither fintech player, nor bigtech firm nor bank.

At the same time, it must be ensured that there is fair competition between all parties. In order to achieve this goal, we have also made it possible for third parties, including fintech firms, to gain access to account data with the introduction of PSD2. We hope that competition will intensify as a result and payments will ultimately become even more efficient.

The challenge is developing regulation for all providers, from which banks, fintech players and, above all, customers benefit. In this context, dialogue plays a major role, and evenings like tonight can help us to start talking with one another. After all, unlike our predecessors in the Teutonia Club 150 years ago, we don’t cut ourselves off and sing German folk songs; instead we want to learn and benefit from one another. And I am certain that here in Singapore, one of the world’s leading fintech hotspots, here is much to see that will enable us to better understand and learn.

Ladies and gentlemen, I wish you a pleasant evening with many interesting conversations.

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[1] www.handelsblatt.com/finanzen/banken-versicherungen/start-up-branche-wenige-glaenzen-viele-scheitern-bei-fintechs-rollt-die-pleitewelle/24505994.html

[2] BIS: FSI Insights “Innovative technology in financial supervision (suptech) – the experience of early users”.