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Regulating fintech: is an activity-based approach the solution?

Seventh Meeting of the FinTech Working Group

Fernando Restoy

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Views expressed are those of the presenter and do not necessarily reflect those of the BIS or the Basel-based standard-setting committees.

Motivation

- "Same activity, same regulation": a successful slogan
- …for the industry

  "Everyone (should be) operating under the same set of rules" (Marcus Scott (City)) in front of the UK parliament (2019)

  "…same activity should receive the same regulatory treatment, regardless of the entity undertaking that activity" (IIF (2018))
- …but also for some regulators

  "Evidence (on non-bank designations) implements an activity-based approach for identifying and addressing potential risk for financial stability" (US FSOC (2019))

  "EU policies should (…) ensure that the same activity is subject to the same regulation" (European Commission (2017))
- Two main (connected) rationales:
  - ensuring a level playing field between banks and fintech/big tech players
  - avoid regulatory arbitrage

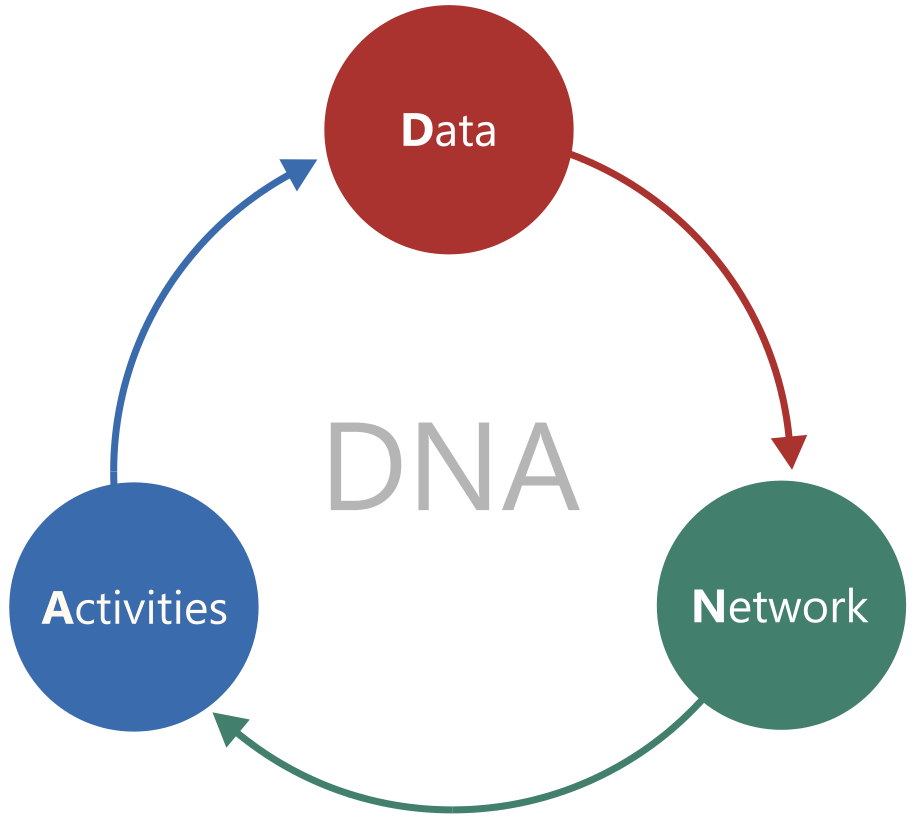
This presentation

- Is an activity-based regulatory approach consistent with primary policy objectives: financial stability, consumer protection, market integrity and competition?

- Is it really the most sensible approach for supporting fair competition between banks and fintech/big tech players?

The current setup

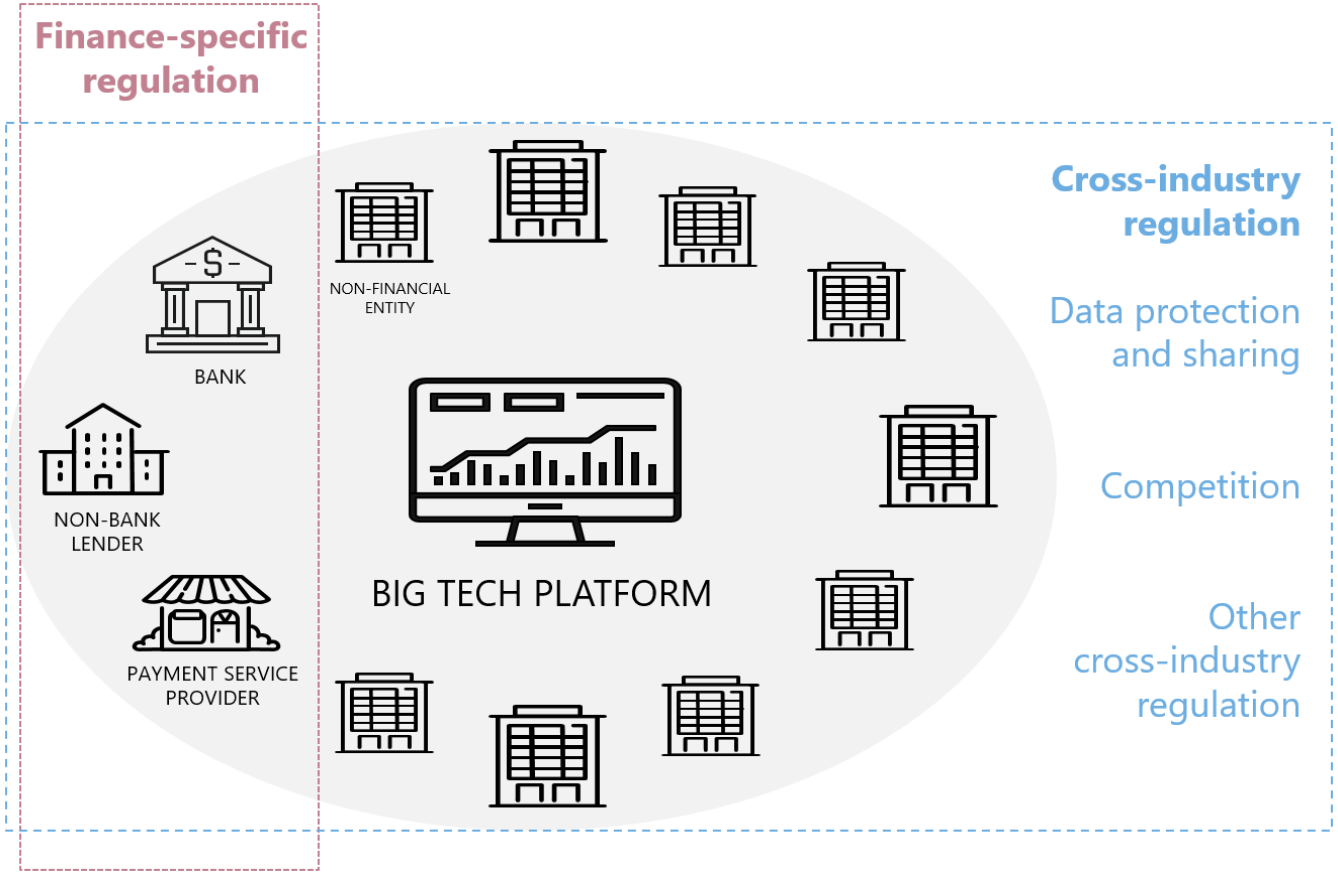
- Big techs increasingly involved in activities where they benefit from **d**ata analytics, **n**etwork externalities and interwoven **a**ctivities – **(DNA) loop**
  - Sufficient number of users, network effects kick in
  - State-of-the-art technologies
  - Gatekeeping
  - Large and captive user base
- As a result, they can **quickly scale up** in market segments that are outside their core business



Source: *BIS Annual Report 2019*, Chapter III, "Big tech in finance: opportunities and risks"

The current setup (cont)

- **No specific regulatory treatment** but need of **licenses** depending on financial services provided
- Big techs subject to a **combination** of
  - **finance-specific** regulations
  - **cross-industry** regulations (cross-sector/horizontal)



Source: Big techs in finance: regulatory approaches and policy options", *FSI Briefs*, no 12:, March 2021.

Can regulatory asymmetries be justified?

- Level playing field does not override primary policy objectives: financial stability, market integrity or, even, fair competition
- Applying same rules to all players only warranted if consistent with those primary objectives
- Seems to be the case in some policy areas: eg AML/CFT, consumer protection
- Not in others (financial stability, operational resilience, competition): risks generated by combination of activities: need for an EB approach
- Unwarranted regulatory discrepancies:
  - if in areas where AB is warranted
  - if in areas where EB rules are required and they are imposed on some but not all classes of entity

Do we see unwarranted regulatory asymmetries?

- Not material regulatory discrepancies for banks and non-banks in policy areas where AB is warranted:
  - AML/CFT rules apply to essentially all professional providers of financial services (eg FATF standards, AML Directive EU, BSA in the United States)
  - Consumer protection rules apply equally to all providers of payment services, credit underwriting, wealth management
  - Albeit there could be discrepancies in implementation, monitoring, supervision: a functional rather than a sectoral architecture of supervision would help (eg CFPB in the United States)
- No sufficient entity-based rules for large fintechs/big techs in areas where EB is warranted
  - On operational resilience: no control of risks generated by combination of activities in big tech platforms
  - On competition: no sufficient ex ante control of possible anti-competitive behaviour by gatekeepers

Recent entity-based initiatives

- To prevent anti-competitive practices
  - United States: House antitrust report (Oct 2020)
  - China: SAMAR's guideline (Jan 2021); PBoC's draft rules for payment service providers (Mar 2021)
  - European Union: EC proposal for DMA (Dec 2020)
- In the European Union, a step forward with EC proposal for DSA (Dec 2020)
  - Requirements for operational resilience
  - Requirements for governance and risk management
  - Audit requirements
  - Supervisory regimes
- In China, regime for financial holding companies updated to accommodate big techs

Takeaways

- Need to revise the regulatory framework to accommodate fintechs and big techs
- Contributing to LPF should be an objective but not above others: financial stability, consumer protection, fair competition
- Moving from EB to AB is not generally advisable:
  - AB rules already there when warranted (although not always homogenously applied)
  - replacing EB with AB may jeopardise financial stability (prudential regulation should remain focused on consolidated balance sheets of banking groups)
- There is a case for relying more on EB rules:
  - to curb risk stemming from the combination of activities big techs perform
  - especially in the areas of competition and operational resilience
- That should help:
  - preserve primary policy goals
  - limit competitive distortions between banks and fintechs/big techs