2. Banks and new digital players

Is there a level playing field?

This article discusses the concept of a 'level playing field' between banks and new providers of financial services, analyses the existing asymmetries in the regulatory and supervisory framework, and proposes some lines of action to advance towards a more level playing field in digital financial services.

In recent years, the financial services sector has undergone a significant transformation that is closely linked to advances in the Internet and mobile technologies. Part of this transformation is the entry of new players into the previously walled garden of financial services, where commercial banks were almost the only providers of the whole gamut of financial products, from credit to deposits, including payment and investment services. Today, a mass of non-bank digital providers compete (and cooperate) between them and with banks in most of the areas of financial services. These new *FinTech* providers are generally start-up firms that specialise in a specific service or customer niche. However, large digital players such as Amazon, Facebook or Apple have also started to offer financial services (mainly, payments and credit) to complement their core value proposition.

Different factors explain the entry of new players into the market of financial services. On the one hand, new technologies have reduced the cost of distribution (mobile channels vs. physical branch networks) and the cost of information technology (IT) infrastructure, thanks to cloud computing solutions. Moreover, digital technologies have facilitated the emergence of new platform business models in which widely dispersed agents are directly matched (e.g. crowdfunding or marketplace lending). On the other hand, today's technology-savvy customers demand a new customer experience (real-time, ubiquitous, transparent, personalised) that has not always been offered by the incumbents.

In this new competitive environment, both banks and other players are calling for a level playing field (LPF) that ensures fair competition amongst the various different providers of financial services. In many cases, however, the concept of LPF has been used with different, even contradictory, meanings. For some, it means lowering the regulatory barriers to entry in the financial sector, whereas for others new players should be subject to the same obligations that are imposed on banks.

The issue is of the utmost importance given the risks involved in providing financial services and consequently, the heavy regulation and supervision to which the sector has always been subject. Ensuring a LPF is not only an issue of fair competition but also of appropriately managing the risks for consumers and for the overall economy.

In our view, the principle of LPF ought to comprise two aspects. First, activities involving the same risks — for the sake of financial stability, consumer protection and the integrity of the financial system — should receive the same regulatory treatment. Therefore, any difference in regulation and supervision should be based on the risks posed by different products and services. Second, there should not be unnecessary barriers to competition in the market beyond those justified by risk considerations. This means, for example, granting different types of players access (under fair conditions) to payments infrastructure, customer data, and regulatory and supervisory guidance, where the latter is aimed at keeping unavoidable risk-justified regulatory barriers to a minimum. In the rest of this article we will discuss the current state of play and how to achieve a more level playing field.

Asymmetries in the regulatory and supervisory framework

Regulations on consumer protection and the integrity of the financial system (Anti-Money Laundering and Combating the Financing of Terrorism) are generally activity-specific and therefore satisfy the principle of LPF, except with respect to certain forms of discrimination based on the size of the firm.[1] However, regarding financial stability, banking groups are subject to prudential regulations that have implications for most of their businesses, including those in which they compete with non-bank players that are only subject to activity-specific regulations or benefit from regulatory loopholes. Therefore, FinTech activities are generally subject to additional rules on internal governance when they are carried out within a banking group.[2] For instance, the EU Capital Requirements Directive (CRD) limits the ratio between the variable and the fixed salary components that financial institutions can pay to certain staff members who are identified as risk-takers. This puts banking groups at a competitive disadvantage in terms of attracting and retaining digital talent and keeping the founders and management teams of acquired start-ups on board.

Existing loopholes in the regulatory framework are another source of an uneven playing field between banks and non-bank players. Some new services or business models are not yet covered under existing regulations. This means that not only are potential risks to financial stability, consumer protection and the integrity of the financial system left unaddressed, but also asymmetries between players arise, given that regulated providers often face obstacles to engaging in unregulated activities. A case in point here is that the European Banking Authority (EBA) recommended that competent authorities should prevent credit institutions, payment institutions and e-money institutions from buying, holding or selling virtual currencies.[3]

The second aspect of the principle of level playing field refers to the removal of unnecessary barriers to fair competition; for example, by facilitating access of all players to payments infrastructure and customer data. The new EU Payment Service Directive (PSD2) takes a step in that direction by allowing non-bank players — authorised as payment service providers — to access bank account data and initiate credit transfers on behalf of clients. However, since these third-parties will not pay for accessing bank accounts, this imposes an unfair burden on banks and creates an asymmetry in the contribution to the sustainability of the payments infrastructure. Furthermore, sector regulations on third-party access to customer data (such as PSD2) might create asymmetries between players in a digital context in which the boundaries between sectors are becoming blurred. Although the new General Data Protection Regulation

1: In the European Union, the General Data Protection Regulation and the Anti-Money Laundering Directive set maximum administrative fines as a percentage of the total worldwide annual turnover of firms and the net equity of the obligated entities, respectively. This proxy is common when enforcing all types of regulations, and penalises larger players, who are not necessarily those taking larger risks.
2: Under the EU prudential regulatory framework (CRR/CRD), all financial service activities (except insurance) fall within the perimeter of prudential consolidation for banks and are therefore subject to prudential regulation and supervision. Only some exceptions are allowed, based on the immateriality of subsidiary firms.
3: EBA Opinion on 'virtual currencies', July 2014.

(GDPR) will bring in a new right to personal data portability which applies to all sectors, this way of accessing customer data will be less standardised than in PSD2 and only affects individual customers (whereas PSD2 also applies to business accounts).

Towards a more level playing field

To ensure a level playing field among all providers of financial services, be they banks or not, the regulatory and supervisory framework should progress on three fronts:

- **Limiting the implications of prudential regulation** for non-core businesses (i.e. non deposit-taking activities) in which banks compete with non-bank players. The internal governance of these businesses should be subject to the same activity-specific regulations that apply to non-bank players. To this end, either exceptions within the regulatory framework or exclusions from the perimeter of prudential consolidation could be allowed.

- **Plugging existing gaps in the regulation** by developing a regulatory and supervisory framework for new services, such as virtual asset management, alternative finance or financial service marketplaces. These rules should apply to both banks and non-bank players, the latter being authorised by narrowly defined (activity-specific) FinTech licenses.

Facilitating innovation for all players, under safe and even conditions, in case regulatory obstacles or uncertainties come to hinder the development of innovative solutions that would benefit consumers. Regulatory sandboxes are a useful tool in this respect. They are controlled environments in which firms can test innovative solutions with real customers without immediately incurring all of the normal regulatory burden.

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