

Fintech, Competition, and Innovation

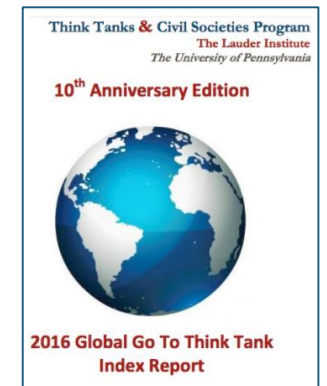
Presentation to Bangko Sentral ng Pilipinas

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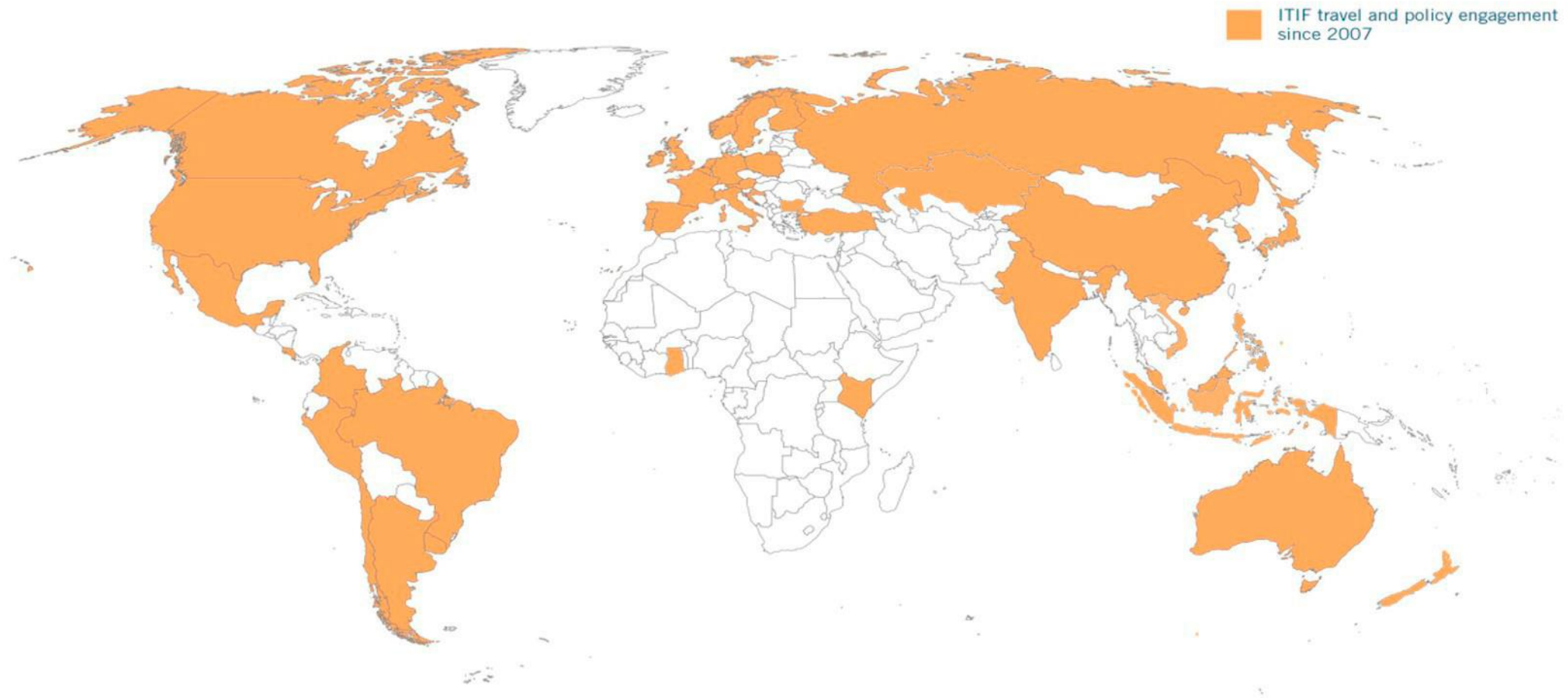
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About ITIF

- The world's leading science and technology policy think tank.
- Supports policies driving global, innovation-based economic growth.
- Focuses on a host of issues at the intersection of technology innovation and public policy across several sectors:
 - Innovation and competitiveness
 - IT and data
 - Telecommunications
 - Trade and globalization
 - Life sciences, agricultural biotech, and energy



ITIF Global Engagement



Role of Government

- Competition authorities support competition.
- Financial service regulators support prudential safety and consumer protection.
- But with the inflection point of Fintech, both should focus more on supporting transformational innovation.



Today's Presentation

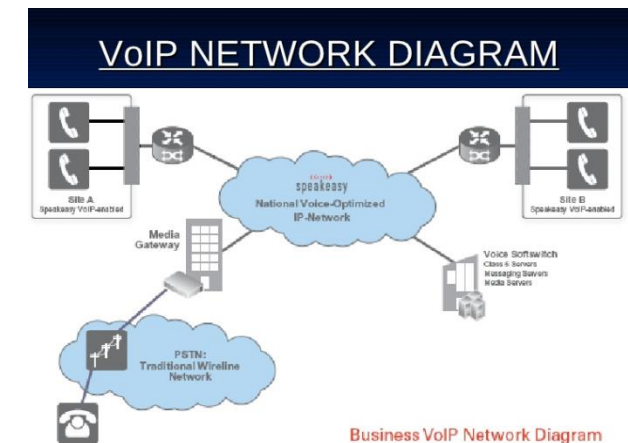
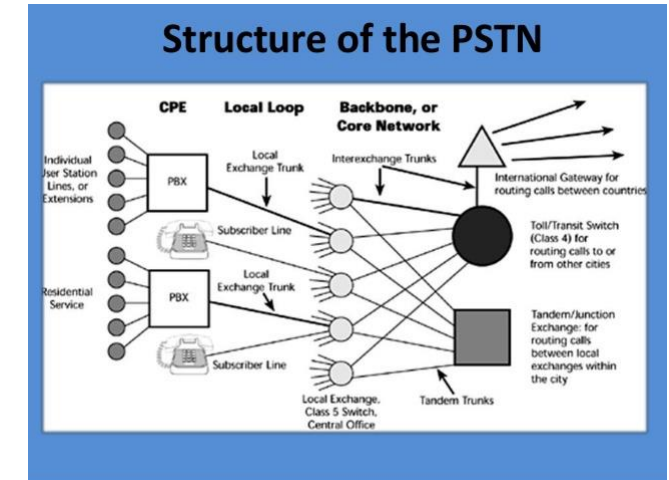
1 The Vision

2 The Challenge

3 The Barriers

The Vision

- “Open banking” where Internet-protocol-based financial transactions become dominant.
- Allow Internet protocols to do for banking what Skype did to telephone, Uber did to taxis, and WhatsApp did to messaging.
- A fundamentally more-efficient, lower-cost, more-globalized, and more-consumer friendly (e.g., mobile-first) model.



Yet Innovation Isn't Easy...Some Puzzles to Ponder...

Why didn't IBM keep the operating system?

Why didn't Western Union buy the telephone?

Why didn't Microsoft create the browser?

Why didn't Netscape create the search engine?

Why didn't AT&T create AOL?

Why didn't Sears create Wal-Mart?

Why didn't American Airlines create Southwest?

Why didn't Citibank create PayPal?



It takes effort to stand in the future and see new possibilities.

Just because you aren't willing to disrupt your own business, doesn't mean somebody isn't willing to do it for you!

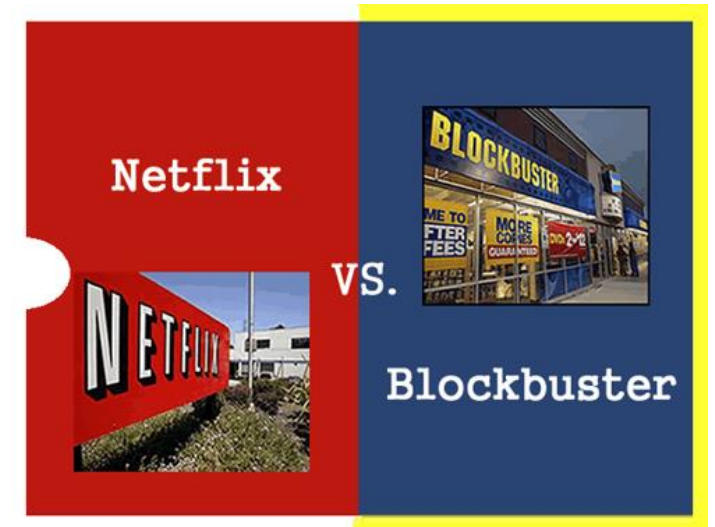
Too many companies—and even countries—don't recognize the need to innovate until it's too late.

The Real Nature of Fintech Competition

- “In capitalist reality, as distinguished from its textbook picture, it is not [price] competition which counts but the competition from the new commodity, the new technology . . . which strikes not at the margins of the profits of the existing firms but at their very lives.”

(Joseph Schumpeter, *Capitalism, Socialism and Democracy*)

- Incumbents might thrive if they take Clayton Christensen’s words to heart: “If a company is going to cannibalize your business, you’ll almost always be better off if that company is your own, instead of a competitor.”



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The Challenge:

- Incumbent banks have relatively weak incentives for innovation, explaining why most maintain multiple types of legacy and dedicated software, rather than replacing them with integrated, interoperable systems.
- Banking is a network industry where producer and consumer decisions are interdependent and where utility depends upon decisions of other network participants.
- That's one reason for the slow rate of change: adoption of new technology in banking requires coordinated change and that depends on sometimes non-existent or even negative incentives.

Experience of Other Disruptive Technologies: Communications

- New entrants were based on different technologies (e.g., Internet protocol) that was fundamentally more efficient.
- Some incumbents resisted (e.g., blocking of Skype by incumbent telcos).
- Role of regulators was to prevent incumbents from unfairly foreclosing entry.



Experience of Other Disruptive Technologies: Transportation/Lodging

- IP, combined with smart phones and GPS, transformed ride services. Web 2.0 transformed lodging.
- Incumbents (taxi companies/hotels) resisted and tried to block new entrants, in part by insisting they comply with regulations designed for “bricks and mortar” businesses.



Experience of Other Disruptive Technologies: Real Estate

- Internet-enabled, online realtors allowed lower-price real estate transactions by enabling more self-service.
- U.S. realtors fought back by trying to restrict access to the Multiple Listing Service (MLS).
- U.S. DOJ brought civil antitrust case against National Association of Realtors regarding restrictive access to MLS.

REDFIN



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Barriers for Fintech Entrants

- Access to incumbent financial institutions.
- Access to government regulator data.
- “Bricks and mortar” regulations.
- Standards and standards processes.

Access as a Barrier to Competition

- Can Fintech businesses access the services they need from incumbent institutions to compete in the marketplace?
 - Some Fintechs need access to banking networks, especially if they are denied banking charters.
- In America, some financial institutions prohibit third-party apps and services that help consumers manage their finances, such as Mint, Yodlee, LearnVest, and Personal Capital, from accessing their customers' data on their behalf.
- The German competition authority ruled against the German Banking Industry Committee's restrictions on Internet payment services as being a breach of German and EU competition law.
- We need “*Bank Neutrality*.”



Access: Banks

- Fintech entrants need access to banks' open APIs, just as Uber uses an open API to embed Google maps in its app.
- Open APIs are interfaces between software programs of different organizations so they can automatically “talk” to one another.
- Because governments already regulate financial services, there is no reason not to require data portability and require APIs to allow consumers to pull data into third-party systems.
- The UK Treasury established an Open Banking Working Group that developed a standard for "open banking" (The Open Banking Working Group, 2016) in which APIs are used to provide third parties with wide-ranging access to bank platforms.
- Governments need to require banks to use APIs to open up consumer payment accounts for appropriately licensed, innovative service providers.

Regtech, APIs, and Improving Transparency

- Open APIs for government databases, such as complaint and mortgage data.
- U.S. Consumer Finance Protection Board has a complaint database with API capabilities that fosters easy uploading and analysis by others.
- In the future, a Yelp! for financial services.



Overcoming Regulation as a Barrier

- Support Regulatory “Sandboxes.”
 - U.K. Financial Conduct Authority’s Project Innovate
 - The Monetary Authority of Singapore’s Fintech Regulatory Sandbox
 - Australian Securities and Investments Commission’s Fintech regulatory Sandbox
 - U.S. Consumer Financial Protection Bureau’s Project Catalyst



“Regulating Up” as a Barrier

- Goal of regulation should not be “parity of regulation” but rather “parity of protection.”
- Incumbents want to regulate new entrants up to their level.
- That seems fair. But Uber and Airbnb don’t require the same regulation as incumbents because consumer rankings act as regulatory protection.
- Fintech, for new entrants or incumbents, could have similar transparency.
 - In peer-to-peer lending, lenders could rate borrowers and vice versa. Transparency on paying back.
 - Regulators could insist on real-time compliance systems that would provide regulators to monitor, in quasi-real time, the actions of the company and identify any non-compliant behavior.

Sub-National Regulation as a Barrier

- Banking was place based (branches) and so regulation was place based.
- Fintech is in cyberspace and so should be regulated nationally.



Standards as Barriers

- Incumbents can be reluctant to agree to technological innovation that substitutes for their services and can use standards to thwart that.
- In the Internet space, open standards that allow entry can be much easier, in large part because the standards bodies can represent a diversity of organizations and stakeholders.

Conclusion

- Remember finance is a platform industry, whose innovativeness impacts the competitiveness of all other economic sectors.
- The sector depends on access to open, cross-border data flows.
- Policymakers should seek greater global harmonization in laws and regulations affecting the financial services industry, for instance in routing transactions, anti-money-laundering, and international access to financial data for law enforcement.

Muchas Gracias!

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