

COMPETITION IMPLICATIONS FOR FINTECH

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GLOBAL PAYMENTS WEEK 2018

KUALA LUMPUR, MALAYSIA

DECEMBER 3-7, 2018



Foreclosure of FinTech?

EUROPEAN UNION PSD2 (JANUARY 18, 2018)

- Third-party providers are legally recognized and must fulfill certain conditions (license, registration)
- Consequently they are subject to supervision by the banking authorities
- Access to the data range is regulated
- **Right of access to payment account's info [obligation by banks to offer application programming interfaces (APIs) that provide access to account information to third parties]**

The Netherlands ACM's Report "Fintechs in the Payment System: the Risk of Foreclosure" (19 December 2017)

ACM distinguishes between:

- **Front-end providers**, which are Fintech offering new payment initiation services, such as payment apps, or new services, such as electronic financial management programmes
- **End-to-end providers**, which are Fintech arranging the entire payment process

ACM=Authority Consumer and Market (competition authority)

Front End Providers

“For establishing a risk of foreclosure, a bank must have a dominant position in the upstream market. The starting point for defining the market is what the Fintech needs from the bank to make its product functional. ...the crucial input for front-end providers is information about the payment account. In that context, it is relevant that only the bank where the customer has a payment account has access to the details of that customer’s payments and transactions. ... This unique bank-customer relationship and the confidentiality of the information arising from it mean that, in the case of front-end providers, there is no generic market for payment accounts. The relevant upstream market can be defined as the market for information about the payment accounts of a specific customer. **It follows from that definition of the market that banks have a dominant position, since, for every payment account, there is only one bank that possesses the information about that account.**” (p. 26)

Front End Providers (CONT.)

“For banks, the apps for mobile banking and payment are often the most direct method of access to their customers. This direct contact creates advantages for offering other banking services. The bank’s direct access provides it with a lot of information about customers, and makes them easy to reach. Banks therefore often regard the loss of this direct contact due to customers switching to the apps of other providers as one of the biggest threats they face. This is an important indication that banks expect more competition in other banking markets. **It is plausible that banks attach great importance to avoiding this competition and therefore have an incentive to foreclose front-end providers.**” (p. 29)

End-to-End Providers

“A formal assessment of the existence of joint market power takes a great many factors into account. However, further consideration of just two of those factors already shows that joint market power is unlikely. First, there are a great many suppliers of payment accounts. As a rule, the larger the number of providers, the more difficult collusion becomes. Specifically, it seems quite unlikely that all those providers will be able to reach agreement that a particular end-to-end provider will not receive a (decent) offer. Second, there are major differences between the suppliers. For some suppliers, an end-to-end provider will represent a threat, but, for others, it will represent an opportunity to secure more customers and turnover. **In view of these varying positions, collusion is unlikely.**” (p. 32)

GERMAN BANKING INDUSTRY LAW TO VIOLATE INDUSTRY LAW

- In 2016, the German competition authority declared that banks' terms and conditions violate competition law by restricting alternative online payment services.
- The ruling prevents banks from trying to restrict consumer access to third party solutions, such as apps, built on top of bank infrastructure.
- In line with PSD2.

GERMAN BANKING INDUSTRY LAW TO VIOLATE INDUSTRY LAW (CONT.)

- The *Bundeskartellamt* affirmed that German banks violate competition law by enforcing special condition for online banking, which cause that customers cannot use their PINs (personal identification numbers) and TANs (transaction authentication numbers) in non-bank payment systems.
- This stance would have "significantly impeded" the use of non-bank providers for online purchases, preventing people from using lower-priced alternatives.
- Banks argued that their rules are designed to ensure the security of their online customers, but the *Bundeskartellamt* dismissed this argument, stating that the rules used could not be considered as a necessary part of a consistent security concept of the banks, and they would impede non-bank competitors.

UK OPEN BANKING

- Regulatory Technical Standards (RTS) satisfying PSD2 requirements of strong customer authentication (SCA) will only come into force in the second half of 2019. [art. 98 PSD2]
- However, the UK competition authority forced the nine largest banks to put customers' data in a standardized form so that the public can see all of their accounts in one place and easily switch providers.
- Banks that take part have to give registered third parties access to their data if requested, introducing privacy and fraud concerns.

Foreclosure by FinTech?

Study Commissioned by the European Parliament

Competition Issues in the Area of Financial Technology (July 2018)

- A service-by-service approach based on the business model of each service category was used in the Study to explain the competition issues. However, strong commonalities in FinTech competition challenges that go beyond a particular service or operator, were identified:
 - **Supply-side.** Two categories of technology have great influence in explaining competition challenges: online platforms and the intensive use of data.
 - **Demand-side.** Relevance of the way users access and operate FinTech technologies and their behavior and perception of FinTech technologies as a means to deliver financial services.

MAIN CONCERNS

- The combination of platform technologies and the access and operations by users can result in competition concerns related to **interoperability** and **standardization**. User perception and behavior help to identify challenges such as the **definition of a relevant market** and the role of **network effects as a source of market power**.
- The intensive use of data and technology related to technologies such as algorithms and AI may lead to **interoperability** concerns, **exclusion of users**, **price discrimination**, practices of **tying and bundling** and even **tacit collusion**.

DEMAND AND SUPPLY SIDE PERSPECTIVES

	Demand-side perspective		
Supply-side perspective		User access and operation	User perception and behavior
	Platforms dynamics	Interoperability; Standardization	Relevant markets (users' distinction of services); Network effects arising from use patterns (single/multi-home use, intensity,...)
	Data	Portability; Interoperability; Data algorithms & exclusion; Price discrimination; Predatory pricing	Portability; Data and market power; Cross-usage of datasets and shadow banking; Data access (competitors' exclusion discrimination); Digital pricing, AI use & collusion (models and data training)

MULTI-SIDED ONLINE PLATFORMS

- The use of multi-sided online platforms to provide FinTech services implies that the definition of the relevant market cannot be undertaken following traditional models built on the premises of pipeline businesses where value is generated by the supplier of a product or a service.
- **In the case of platforms, the value or a large part of it, is generated by the users on the other side.**

Reference: *case law on on-line platforms for e-commerce.*

NETWORK EFFECTS

- Network effects augment the risk that multi-sided network effects enable a large platform to be insulated from competition from smaller platforms with fewer participants and can create barriers of entry. It is particularly relevant whether users tend to choose only one provider ('single homing') or several providers ('multi-homing').
- **Network effects increase with the intensity of use and the single-homing nature of the platforms.**

INTEROPERABILITY

- This problem arises when the lack of interoperability between two technologies is used by incumbents as an (artificial) barrier of entry for newcomers.
- An active pursuit of non-interoperability can act as a deterrence with anticompetitive effects if access to the market is difficult or costly.

STANDARDIZATION

- Standardization required to facilitate interoperability might become a source of noncompetitive behavior, if firms lack the incentive to innovate and differentiate.
- If standardization lowers entry costs and prices, and/or allows firms to compete on more core parts of the service, then it has a positive effect.
- However, standardization may also result in an oligopoly where providers may take the opportunity to agree on features of the service to split the market between them.

ACCESS TO DATA

- Control over unique data troves, resulting from the combination of datasets from multiple sources, is one of the main factors considered when assessing potentially anticompetitive behaviors.
- They can result in, for example:
 - **exclusionary conduct** when not allowing competitors to access data,
 - **the conclusion** of exclusive contracts, if the incumbent uses its control over a particularly valuable dataset to create **a network of contracts that forecloses competition**, or
 - **tying and bundling** of services, leveraging the firm's position and imposing the use of other services.

COMPUTER ALGORITHMS

- Computer algorithms themselves may also result in anti-competitive practices.
- They may do so in a way that promotes express and **tacit collusion** because they can learn by themselves and conclude that the best way to maximize profits is to develop collusive practices.

MARKET DEFINITION

“In the UK M-Commerce decision, the Commission considered that online and offline mobile payments were not likely to be part of the same relevant product market. While the Commission concluded that the situation could evolve in the short to medium term, it ultimately left the product market definition open. With regard to the substitutability of remote/online mobile payments and other types of remote/online payments, the Commission concluded that they may belong to different product markets, but ultimately also left the product market definition open in that respect. The Commission reached a similar conclusion in relation to the mobile proximity/offline payments and existing proximity/offline payment solutions.” [*Bite/Tele2/Telia Lietuva/JV, 19.07.2017*]

APPLE PAY CASE IN AUSTRALIA (1)

- In July 2016 four Australian banks sought authorization from the Australian Competition and Consumer Commission (ACCC) to engage in limited collective negotiations with Apple on conditions related to competition, best practice standards and efficiency and transparency regarding access to the iPhone NFC chips. They also sought authorization to enter into a limited form of collective boycott in relation to the Apple Pay service while collective negotiations with the firm were ongoing.
- They argued Apple had a significant bargaining power in negotiations related to its payment service Apple Pay due to its control of both the operating system (OS) and the mobile hardware, as well as its high share of the smart-phone market in Australia.
- Their major claim was that Apple only allowed its own integrated contactless payment option, Apple Pay, on Apple devices, impeding access to the NFC chip to any other applications for mobile payments developed for third parties. All banks must use Apple Pay to provide payment services to the Apple devices owners.

APPLE PAY CASE IN AUSTRALIA (2)

- In March 2017, the ACCC rejected granting the authorization to negotiate collectively with Apple.
- The ACCC stated that Apple was not a monopoly supplier of mobile phones, facing great competition from several manufacturers and Google's Android operating system.
- Although the ACCC recognized that Apple had significant bargaining power in negotiations, it was the result of the vertical integration from device hardware to operating system software and mobile applications software.
- The ACCC finally emphasized that opening access to the NFC controller could result in a significant distortion of competition in mobile operating systems, as it could affect Apple's current integrated hardware-software strategy for mobile payments and, more generally, OS.
- As a result, each bank must reach individual agreements with Apple to allow its customers to use the Apple Pay service.

Competition Tools, Regulatory Intervention, or a Combination Thereof?

UK OPEN BANKING

- RTS are drafted by the European Banking Authority, that is an independent agency whose scope of activity covers banking supervision.
- The UK Open Banking initiative was yet led by the Competition and Market Authority (CMA).

CONCLUSIONS OF THE DUTCH ACM (1)

Measures against foreclosure of front-end providers

- The PSD2 Directive does not provide ACM with any additional instruments with which to reduce the risk of foreclosure. **Other parties that could adopt measures to reduce that risk are the Dutch central bank (DNB), the European Commission and the Dutch government.**
- ACM makes the following recommendations:
 - Where the PSD2 Directive and the RTS leave scope for differences in the implementation and interpretation of the conditions under which access must be provided, and could therefore lead to uncertainty for market participants, **it is for the regulatory bodies to define those conditions more precisely. That scope, where it exists, should logically be exercised by DNB.**
 - The European Commission allows banks to receive compensation amounting to a maximum of the efficient costs they have to incur to arrange access for other parties. Requiring banks to grant access free of charge could give banks an incentive to exclude fintechs.
- **The government should introduce a banking license ‘light’ for fintechs**, which would give fintechs the possibility of offering their own payment accounts.

CONCLUSIONS OF THE DUTCH ACM (2)

Measures against foreclosure of end-to-end providers

- ACM currently sees no major risks of foreclosure in relation to end-to-end providers. We can take measures to enforce the provisions of the PSD2 Directive on access to business payment accounts in specific cases.
- ACM further concludes that direct access to interbank systems for fintechs will reduce the risk of foreclosure.
- Measures that could be taken to achieve this are:
 - **The Dutch government should introduce a banking license ‘light’ for fintechs**, which will give fintechs the possibility of gaining direct access to clearing and settlement systems.
 - The definition of **objectified criteria for access that match the risks arising from the activities** performed by these institutions.
 - A guarantee that, in the development of instant payments infrastructures in Europe, fintechs will be able to participate directly in the systems and agreements for **clearing and settlement on equal and objective conditions**.

CONCLUSIONS OF THE STUDY FOR THE EUROPEAN PARLIAMENT

- The current state of the markets for FinTech services is generally too fluid to reach firm conclusions on the existence of competition challenges that need the deployment of competition tools on a large-scale basis.
- FinTech services, as part of the digital economy, share potential competition challenges with other digital businesses, mainly those derived from the provision of services through digital platforms and the access to customer data. Thus, the remarks regarding competition in the digital environment remain valid in the FinTech ecosystem.
- **The special role of regulation in the field of financial services sends a message of caution about the appropriateness of competition policy tools as the preferred means to address every challenge.**

COMPETITION CHALLENGES FALLING OUTSIDE COMPETITION POLICY TOOLS (1)

- The challenges of defining the relevant market and network effects are largely determined by the (demand-side) factors of user perception and behavior. User's perception of a certain service can depend on the transparency of the provider, which, in turn, depends on its disclosure duties. Likewise, these duties can influence user behavior, e.g. more complex disclosure protocols can foster intensity of use and single-homing. **However, these are investor protection provisions, which impose certain duties on financial intermediaries.**
- Users' access and operation of the technology depend on entry costs. Yet, a major part of entry costs is related to regulatory requirements. **These elements are part of licensing and regulatory requirements.**

COMPETITION CHALLENGES FALLING OUTSIDE COMPETITION POLICY TOOLS (2)

- The role of data as a source of market power is largely influenced by users' decisions to provide their data. Regardless of the solution that may be more appropriate for fostering competition, this will always be subject to the provisions of **data protection and privacy laws**.
- In some cases, the balance between the interest of the new entrant, the incumbent and the user is complex enough to have been the subject of **specific regulations outside data protection**.
- The ease of access and operation by the user is determined by pure technical factors, e.g. how well the technologies of a bank and a PSP interoperate, as well as more subjective factors, such as whether the payment interface is user-friendly. Issues such as the layout of the information and the transparency of the conditions are a matter where **consumer protection laws** are a relevant component.

THANK YOU!!!