Organisation for Economic Co-operation and Development

DAF/COMP/WD(2019)54

Unclassified **English - Or. English**

16 May 2019

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

Digital Disruption in Financial Markets – Note by the United Kingdom

5 June 2019

This document reproduces a written contribution from the United Kingdom submitted for Item 5 of the 131st OECD Competition committee meeting on 5-7 June 2019.

More documents related to this discussion can be found at

http://www.oecd.org/daf/competition/digital-disruption-in-financial-markets.htm

Please contact Mr. Antonio Capobianco if you have any questions about this document
[E-mail: Antonio.Capobianco@oecd.org]

JT03447560

United Kingdom

1. Development of FinTech in the UK

1. In recent years, FinTech has grown significantly in the UK. FinTech is present across a range of financial sectors. Key areas include banking, payments, online investments, SME lending, analytics and big data, InsurTech and digital ID[1]. The UK accounts for 11% of the global FinTech industry with 76,000 people working in FinTech across the UK[2].

2. The growth in FinTech is delivering significant benefits to UK consumers, leading to better quality existing services and/or services being offered at a lower cost. In addition, FinTech is delivering entirely new services and propositions including some which are focussed on better serving vulnerable consumers. These have included innovative approaches to delivering financial advice, assisting consumers make better financial decision through behavioural "nudges" and tailored flood insurance[3].

3. Key aspects of FinTech offerings often include ease of use, ease of access, agile processes and a strong focus on addressing particular consumer or market needs. The presence of new, innovative entrants in the market could potentially encourage consumers to shop around and switch providers. This in turn could present a competitive threat to incumbents. In response to such increased competition, many incumbents have started to develop solutions to deliver these same benefits to consumers, as they seek to meet competition from start-ups entering the market.

2. FinTech in the UK retail banking market

4. Many larger firms are now developing tools that are more agile and responsive to consumer needs. This is particularly the case in retail banking and the FCA's Strategic Review of Retail Banking[4] found that while traditional banks have done well at providing basic payments functionality and infrastructure, they have arguably done less well at helping consumers to manage their spending.

5. Many of the newer competitors offering current accounts differentiate themselves by harnessing technology and consumer data to combine insights and money management tips as part of their current account services. We found that incumbents themselves are now investing in FinTech services, for example, in developing aggregator apps to allow customers to view data from multiple accounts (and so make it easier for consumers to have an overview of their money). Many banks have implemented digital strategies, which have included launching digital banks or solutions and developing tools to allow consumers to

[1] EY, Sept 2017, UK FinTech Census 2017.

[2] City of London, Oct 2018, FinTech in the UK.

[3] FCA, May 2015, Regulatory sandbox.

[4] FCA, June 2018, FCA publishes update on wide-ranging review of retail banking sector.

track their spending, provide account prompts, and use cloud technology to store important documents.

6. Many of these developments in retail banking have, at least in part, been driven by the development of Open Banking. Implemented following a CMA market investigation into retail banking, Open Banking enables customers to share their data securely with trusted third parties such as FinTechs and other banks, enabling them to compare products on the basis of their own requirements and to use banking services made available by new digital service providers.

7. The roll-out of Open Banking commenced in January 2018, and in its first year there have been a number of promising developments.

8. There are currently around 50 providers of open banking services who are active in the market, with a further 140 applications for registration or authorisation currently in the pipeline. The volume of activity via open banking API calls has risen from 2 million in July 2018 to 27 million in February 2019.

9. Open banking services comprise two categories: account information and payment initiation. The former are provided by entities described as AISPs (account information service providers) and the latter by PISPs (payment initiation service providers). The entities providing these services could be FinTechs or banks themselves

10. AISPs are able to offer customers a view of all their payments service transactions (for example current accounts, credit cards) through a single "dashboard". AISPs doing so are described as "aggregators." Many aggregators offer analytics/graphics/metrics to help consumers manage their finances better, for example pointing out where they could save money such as money management app, Yolt. In addition, aggregators may use the data about ther customers' transactions to identify money-saving opportunities such as a cheaper mortgage.

11. PISPs move money into and out of customers' accounts with their advance permission. These include "sweeping" services which monitor a customer's balance and pay money into their account if they are about to become overdrawn and incur charges. Sweeping services can also be used to transfer surplus cash automatically from a checking to a deposit or other form of savings account, earning the customer a higher rate of interest. One example of a FinTech providing such services is Safety Net Credit.

12. We believe that Open Banking, and the related services many of these FinTechs provide, are benefiting consumers and competition. Although these FinTechs do not generally offer a full range of banking services (though some, like Monzo and Revolut now do) they are a source of competition for the banks' most profitable retail customers. They also provide consumers with useful tools for comparing a range of financial products. This is a good example of where intervention by the competition authority, alongside new regulation has been instrumental in encouraging the emergence of positive innovation by FinTechs.

3. The application of regulation and competition law

3.1. Encouraging innovation in financial services

13. The FCA has taken a number of steps to encourage innovation and ensure regulation does not act as a barrier to entry for new entrants or deter smaller businesses from expanding.

14. The FCA launched its Innovate programme in October 2014 as a way of enabling innovation that works in the interest of consumers; supporting the FCA's statutory objectives of promoting effective competition while ensuring consumers and market integrity are protected. Since launching, the Innovate initiative has received over 1,500 applications, and supported almost 700 firms[5].

15. A key element to promoting effective competition is to ensure that regulation does not inhibit innovation that offers significant benefits to consumers, while ensuring there are no gaps in policy that could create harms to markets or consumers. The FCA's Innovate programme encompasses several activities, explained in more detail below.

16. In April 2019, the FCA published an evaluation of its approach to innovation, finding that innovation is happening at scale and benefiting consumers - incumbent firms are responding to new challengers to improve their own offerings, and firms supported by Innovate are bringing beneficial innovations to market at greater pace. The FCA found that firms using the Innovate service were authorised, on average, 40% faster than under standard authorisation processes. The report also found that firms supported via the Innovate initiative were receiving significant levels of market investment[6].

17. By supporting individual firms to get to market, the FCA believes that this creates positive competitive pressures on existing firms to evolve and improve their offering, creating more positive outcomes for consumers, such as lower cost and higher quality products and services.

3.2. Direct support

18. The FCA's Direct Support service (known in many jurisdictions as an 'Innovation Hub') provides a dedicated contact point for innovative firms; large or small, authorised or unauthorised. The function provides regulatory feedback for those business models that are genuinely innovative and provide a clear consumer benefit.

19. Regulatory feedback can take the form of informal steers, more formal individual guidance, signposting or assisting the firm through the authorisation process.

20. Since launching, the Direct Support function has received over 1,100 requests for support of which over 500 firms have been provided with assistance. There are no limits on the number of firms the team supports: decisions are made against the transparent eligibity criteria available on the FCA's website[7].

[5] FCA, April 2019, The Impact and Effectiveness of Innovate.

[6] FCA, April 2019, The Impact and Effectiveness of Innovate.

[7] FCA, May 2015, Eligibility for Innovation Hub.

21. The Direct Support function helps to create a level playing field and, while open to all, is particularly useful for smaller firms where the costs associated with getting detailed regulatory feedback may prevent good ideas from progressing.

3.3. Sandbox

22. The sandbox allows businesses, both start-ups and incumbents, to test out new, innovative financial products, services or business models in a live environment. This does not mean transferring risks from firms to consumers, does not reduce the level of consumer protection, or remove/amend the regulatory requirements. Customer safeguards are agreed upfront, as well as robust bespoke supervision by the FCA for the period of the test.

23. The sandbox operates on a cohort basis, with generally two cohorts per year. Demand has been high – 118 firms have been accepted for testing across the first five cohorts of the sandbox. The FCA takes competition law considerations into account in deciding whether or not to accept a firm for testing.

24. The sandbox allows regulators to understand how innovative business models work in markets, and identify gaps in existing policy while ensuring new ideas have the opportunity to be tested and brought to market in order to facilitate effective competition.

25. On 20 October 2017, the FCA published a lessons learned report on the first year of the sandbox. It set out the sandbox's impact on the market and reflects on lessons learnt from tests that had been, or were, conducted in the sandbox. Insights from tests suggested that the sandbox is succeeding in meeting its four objectives:

- Reducing the time and cost of getting innovative ideas to market with 90% of firms that tested in cohort 1 progressing towards a wider market launch.
- Facilitating greater access to finance for innovators with at least 40% of firms that completed testing in cohort 1 receiving investment during or following their sandbox test.
- Enabling products to be tested and introduced to market through allowing firms to assess commercial viability, consumer reception to pricing strategies, consumer communication channels, business models as well as the actual technology. This resulted in a third of firms in cohort 1 using this learning to significantly change their business model to better meet the need of prospective customers.
- Working to ensure appropriate consumer protection safeguards are built into innovators' products and services through measures such as extra capital requirements, systems penetration testing or secondary review of robo-advice by a qualified financial advisor.

26. In addition, themes have emerged around understanding of financial products, vulnerable consumer engagement and the benefits of new applications of technology.

3.4. Advice unit

27. In 2016, the FCA launched a joint review with Her Majesty's Treasury (HMT) to explore ways in which government, industry and regulators can take individual and collective steps to stimulate the development of a market to deliver affordable and accessible financial advice and guidance to everyone (the Financial Advice Market

Review[8]). The review found that further steps needed to be taken to make the provision of advice and guidance to the mass market more cost-effective, for example through 'robo' advice or the provision of digital guidance.

28. To help address the findings, the FCA created the Advice Unit which provides tailored feedback for firms that are seeking to develop automated advice or guidance services, where these firms can demonstrate they are lowering the associated costs or delivering their service to unservied or underserved consumers. This is focused on 6 different sectors: investments, pensions and retirement income, protection, mortgages, general insurance and debt counselling.

29. The Advice Unit has accepted 38 firms for support, including small FinTech firms as well as large incumbent firms. Five firms have brought their automated models to market following support from the Advice Unit which include NatWest, Nationwide, Santander and HSBC UK. The FCA's Financial Lives Survey published in 2018 showed an encouraging increase in the numbers of consumers seeking financial advice. Although, the number of robo advisers remains relatively low so far, The FCA considers these models have the potential to provide low cost, suitable investment advice at a significant scale over the next few years.

3.5. RegTech

30. The FCA's RegTech work initially focussed on its role as a catalyst for development and adoption of new technologies to support firms' compliance with regulations and risk management. The FCA uses its convening authority in the form of TechSprints to bring together technologists and firms to address social and financial challenges through FinTech. These have included a session dedicated to money and mental health partnered with a UK body aiming to address such issues[9].

31. The RegTech team have developed a series of engagement tools to bring external views into the organisation and develop industry-wide know-how around specific innovations and developments. This includes demo days, where they invite anyone with a RegTech solution to demonstrate their product to a panel of interested parties from across the FCA. This ensures that smaller firms have access to the regulator while ensuring firms of all sizes are able to develop and share their innovative business models.

32. Since 2015, the FCA has delivered TechSprints focussing on regulatory reporting, access and mental health (vulnerable consumers programme) and AML/financial crime. The AML TechSprint in May 2018 was the first Global TechSprint and convened firms and regulators from across the globe. The follow-up TechSprint in July 2019, will focus specifically on Privacy Technology and again will bring a global network of regulators and firms together to work on a solution to an issue that affects every human on the planet.

33. To help inform policy and regulation, the RegTech team also host TechKnows, bringing experts in to bring to life the technology that exists and how it could change the regulatory landscape in the future.

[8] FCA, Sept 2018, FAMR Baseline tracking.

[9] FCA, March 2017, Financial services and mental health TechSprint.

3.6. Global Financial Innovation Network (GFIN)

34. GFIN builds on informal and formal bilateral interactions with numerous regulators about our respective approaches, emerging risks and opportunities in FinTech, RegTech and SupTech space[10]. For new start-ups to compete effectively against incumbents, the ability to scale quickly across markets is important. GFIN was launched in January 2019 as a joint initiative, and involves the FCA and 35 other regulators and related entities[11].

35. For new start-ups to compete effectively against incumbents, the ability to scale quickly across markets is important. The GFIN allows firms to test their innovative propositions in multiple jurisdictions at the same time. It also allows regulators to look at common policy and regulatory issues in order to aid firms of all sizes develop innovative ideas and bring these to market.

36. The GFIN announced a pilot cohort in January 2019, and it received 44 applications from firms to test across 17 jurisdictions. 8 applications have been taken forward by GFIN members for further development of bespoke testing plans. The pilot tests are largely focussed around, RegTech and cryptoasset use cases.

3.7. Start up Units

37. In 2016, the FCA and the Prudential Regulation Authority (PRA), jointly established the New Bank Start-up Unit to help reduce barriers to entry for prospective banks, stimulate competition in the retail banking market and drive innovation to promote better outcomes for consumers. The New Bank Start-up Unit also allows for a range of banking products and business models, including from FinTech firms, to be brought to market. New banks who have engaged with the Unit have ranged from technology-driven mobile-only banks to a new clearing bank that plans to stimulate competition and transparency within the UK financial services marketplace.

38. In 2018, the FCA and PRA jointly launched the New Insurer Start-up Unit, to perform the same function for new insurers looking to join the market.

4. FCA regulatory approach

39. FinTech firms are not regulated in a manner different from other firms within their respective sectors. FinTechs that carry on regulated activities must ensure they have the correct permissions and follow the relevant rules and regulations. Where proportionality exclusions exist in legislation and policy, these can be used by firms.

40. Insights gained from the Innovate programme help inform FCA policy. For example, within the sandbox, distributed ledger technology (DLT) has been the most frequently tested underlying technology. Intelligence from these tests helped inform the FCA of the need to provide guidance on the application of this technology and regulation

[10] SupTech is focused on the development and adoption of new technologies to support regulatory agencies. This includes improving data analytics and automating processes to help regulators better discharge their objectives.

[11] FCA, April 2019, Global Financial Innovation Network (GFIN).

and the FCA published a discussion paper on DLT in spring 2017, followed by a feedback statement setting out our position in December 2017[12]. Another example is the FCA's Guidance consultation on cryptoassets, published in January 2019, which was informed by our experience of businesses operating in sandbox trials[13].

41. Other functions such as our 'TechSprints' have helped inform our understanding of machine learning algorithms and identify opportunities to utilise such technologies to improve the efficiency and effectiveness with which the FCA performs its own regulatory functions.

42. In 2018, the FCA hosted its largest TechSprint to date to investigate how new technologies and greater international collaboration could help to improve the prevention and detection of financial crime. Over three days the team facilitated 260 participants from 105 firms spanning 16 countries – together with regulators and law enforcement agencies from the United States, Europe, Middle East and Asia Pacific – who worked in teams to help develop solutions to prevent and detect financial crime[14]. Lessons learned from these TechSprints have been used in work carried out in international standard setting bodies such as the International Organisation of Securities Commissions (IOSCO), as well as domestically.

43. We also think carefully about how our own policy making could affect competition and innovation. The technological innovation in the loan-based ('peer-to-peer') and investment-based crowd funding platforms market has the potential to transform conventional lending. We have proposed rules for home finance platforms to introduce a level playing field for all platforms seeking to facilitate home finance products, whatever their exact business models. Our proposals aim to provide minimum standards of consumer protection across the market, without inhibiting innovation and growth[15].

5. Application of competition law and merger control

44. Competition law and merger control rules apply to businesses operating in the FinTech sector as they do to all other businesses in the wider economy.

45. Competition law is retrospective in nature, and only prohibits conduct that has affected or is affecting competition on a market. Traditional competition law enforcement is not good at forcing incumbent firms to provide services to new (and potentially rival) entrants promptly, or to connect with new service providers rapidly on reasonable terms, given its requirements for thorough investigation and observation of due process. In recognition of this, proposals for reform of competition law, in particular in digital markets, have recently been put forward to increase the agility of the competition law regime, and

[12] FCA, Dec 2017, Distributed Ledger Technology: Feedback Statement on Discussion Paper 17/03.

[13] FCA, Jan 2019, Guidance on Cryptoassets CP19/3.

[14] FCA, March 2019, Global AML and Financial Crime TechSprint.

[15] FCA, July 2018, Loan-based ('peer-to-peer') and investment-based crowdfunding platforms: Feedback on our post-implementation review and proposed changes to the regulatory framework CP18/20.

enable a swifter response to incumbent conduct that could stifle innovation or exclude entrants.

46. In contrast, merger control rules seek to prevent mergers and acquisitions that could inhibit competition and innovation in the future. The CMA has experience of considering merger control in the FinTech sector. In particular, we recently conducted an in-depth second phase merger investigation into Experian/ClearScore,[16] two firms operating in credit markets, the latter of which is a FinTech firm.

47. Experian is a global business specialising in information relating to personal finance and credit markets. One aspect of its business is as a credit reference bureau, which means that it collates and analyses financial data and other information about individuals and supplies it to credit providers (such as banks) to assist in lending decisions.

48. In addition, Experian offers a range of other consumer-facing and business-to-business services including the provision of pre-qualification services. Pre-qualification services are used by providers of financial product lead generation to tailor the list of matched credit products that they offer to people using the platform according to the prospects of the user being eligible for the product.

49. Experian also provides a free credit checking service which provides users their credit score. This service generates leads for financial products such as personal loans, credit cards, mortgages and insurance. When Experian successfully matches a user to a financial product on its platform, it receives a commission for from the financial product provider. It also offers a paid-for credit checking and maintenance service.

50. ClearScore is a FinTech firm which began operating in 2015. ClearScore offers free credit scores and reports and matches them with personal financial products (including credit cards, loans, mortgages, automotive loans, and insurance products) via its website and mobile app. ClearScore earns commission from the providers of the financial products.

51. The CMA's merger review covered a number of theories of harm including whether after the merger the quality of the parties' free products would be worse compared to what they would be if the merger didn't take place. This theory of harm focussed on the parties' provision of free credit scores and the matching of users to credit products via their digital platforms.

52. In the provisional findings, the CMA assessed the likely competitive impact of the merger by considering a range of evidence. The CMA's approach was significantly influenced by the dynamic nature of the market, particularly regarding entry and expansion by rivals and the improvement of their products and services. Consequently we:

- Reviewed internal documents,
- Examined the expansion plans of the merger parties and their rivals,
- Considered the likely impact of technological and regulatory development such as the UK's Open Banking initiative, the increased use of APIs in financial markets and the second Payment Services Directive (PSD2).
- Assessed the parties' share of (i) total users of free credit scores and (ii) recent new user acquisitions,

[16] CMA, Feb 2019, Experian Limited/Credit Laser Holdings (Clearscore).

- Assessed the parties' product similarities and marketing activities,
- Sent questionnaires and speaking to third parties,
- Assessed evidence on user behaviour.

53. PSD2 and Open Banking were relevant in this case they used API's and engaged in significant consumer data sharing which has the potential to change the market. Possible changes might include the introduction of new products and services or stronger competition and enhanced functionality or improved quality of existing products and services. The CMA considered the likelihood of these very carefully. The CMA also considered whether the merger would alter the parties' incentive to innovate and invest in improvements in their credit score apps and digital platforms.

54. The parties abandoned the proposed transaction close to the final deadline. Therefore, the CMA did not reach a final decision in the case or publish a final report. However, the CMA did publish its provisional findings decision.[17] Although the CMA did not reach a final decision in the inquiry, nevertheless it was apparent that the CMA could undertake a merger assessment of a non-price theory of harm in a dynamic, digital market using current laws and its usual substantive assessment frameworks. This is an example of how the CMA has applied competition assessment to the FinTech market, and acted to preserve future competition and innovation which benefits consumers.

[17] CMA, Dec 2018, Anticipated acquisition by Experian plc of Credit Laser Holdings Limited: Provisional findings report.