

Financial Stability Institute



KCMI Annual Conference

Big tech regulation: in search of a new framework

Based on forthcoming FSI Occasional paper by Johannes Ehrentaud, Jamie Lloyd Evans, Amelie Monteil and Fernando Restoy

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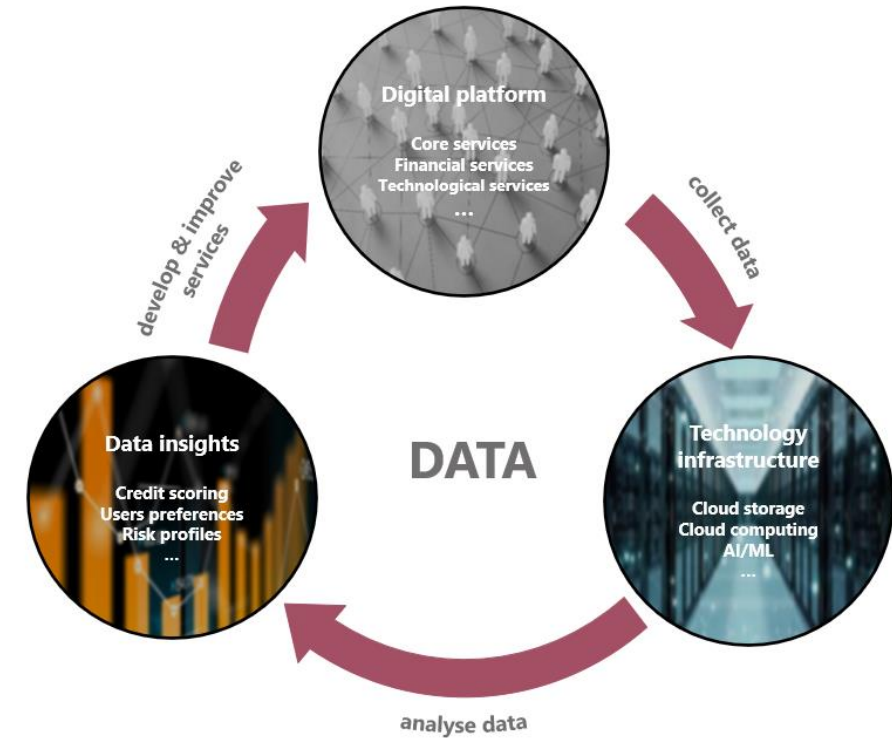
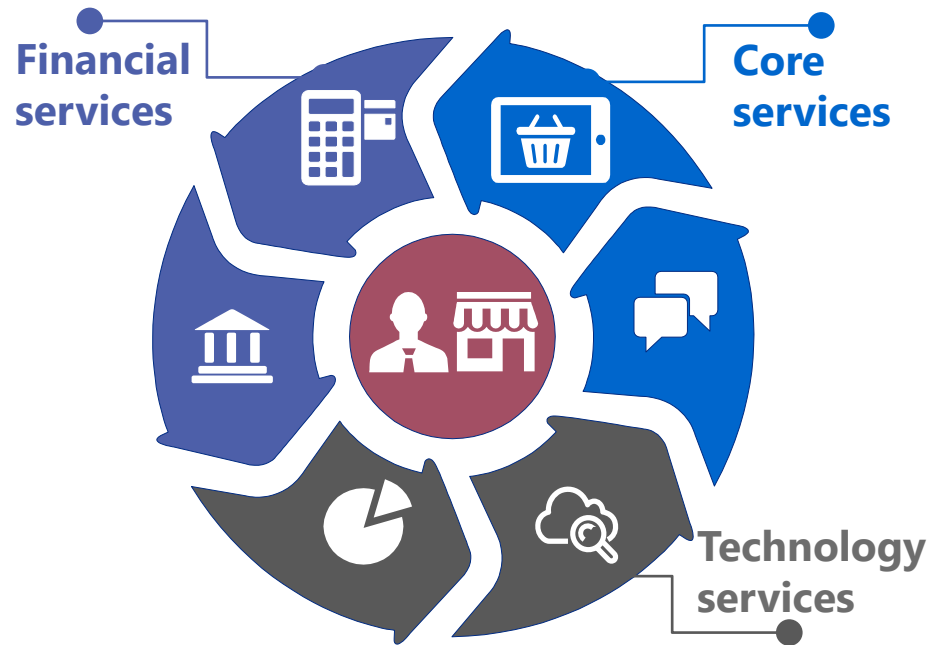
29 September 2022

Views expressed are those of the presenter and do not necessarily reflect those of the BIS.

Outline

1. The issues: business model and risks
2. The current regulatory approaches
3. In search of an appropriate framework
 - The need of an entity-based approach
 - Possible approaches: Restriction, segregation or inclusion
 - The case for segregation
 - The case for inclusion: Inspiration from financial conglomerates
4. A new regulatory category for big techs
 - Scope of application
 - Regulatory architecture
 - Regulatory requirements
 - Supervisory approach
5. Conclusions

THE ISSUES: business model (1)



Source: FSI Insights 44: ["Big techs interdependencies – a key policy blind spot"](#), July 2022

- A unique business model leveraging large amounts of clients' data, cutting-edge technology and strong network externalities.

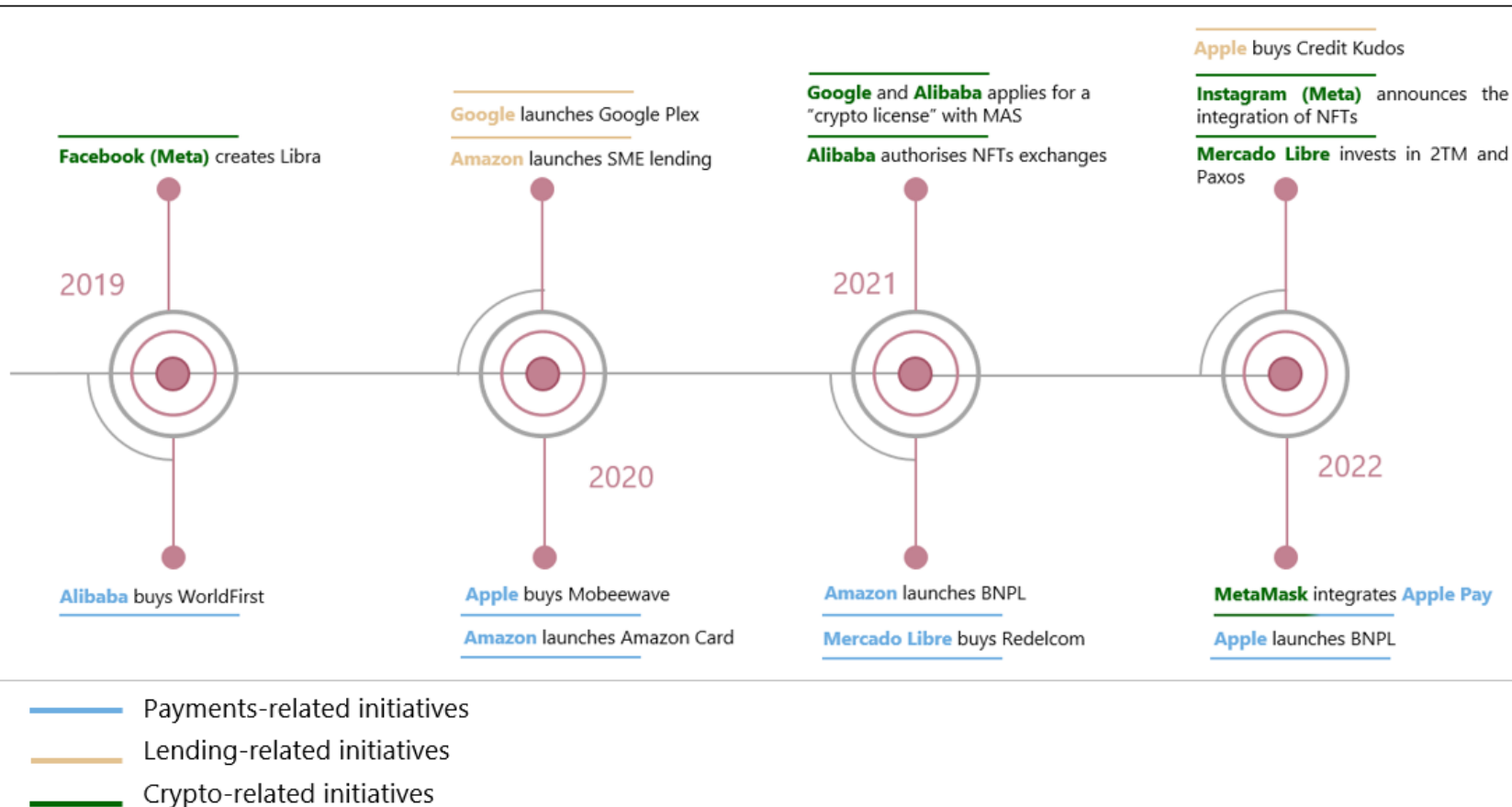
THE ISSUES: business model (2)

Service offerings by big techs under analysis										
	Core services		Financial services					Technological services		
Big tech	E-commerce	Digital Consumer services [#]	Banking [%]	Credit provision	Payments	Asset management	Insurance	Cloud-based solutions [*]	Data analytics	Other ^{&}
Alibaba (Ant Group)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Amazon	✓	✓		✓	✓		✓	✓	✓	✓
Grab		✓	✓	✓	✓	✓	✓		✓	
Jumia	✓	✓		✓	✓					
Mercado Libre	✓		✓	✓	✓	✓				
Rakuten	✓	✓	✓	✓	✓	✓	✓		✓	✓
<p>✓ Provision of financial service through big tech entity and/or in partnership with financial institutions outside big tech group in at least one jurisdiction.</p> <p># Social networks, mobility, deliveries and media services.</p> <p>% The main activity of an entity engaged in banking is taking deposits, though regulations vary across countries.</p> <p>* This includes both cloud-storage and cloud computing solutions.</p> <p>& Other technological services include, for example, telecommunication services, navigation services, digital workplace services.</p> <p>Sources: BIS (2019); Citi GPS (2018); FSB (2019); IBFED and Oliver Wyman (2020); Van der Spek and Phijffer (2020); public sources; FSI.</p>										

➤ Wide variety of (interconnected) commercial and financial activities ([Crisanto et al, FSI \(2022\)](#)).

THE ISSUES: business model (3)

Recent big tech initiatives in financial services



Source: FSI Occasional Paper (forthcoming).

➤ Continued increase of financial activities

THE ISSUES: risks for financial stability

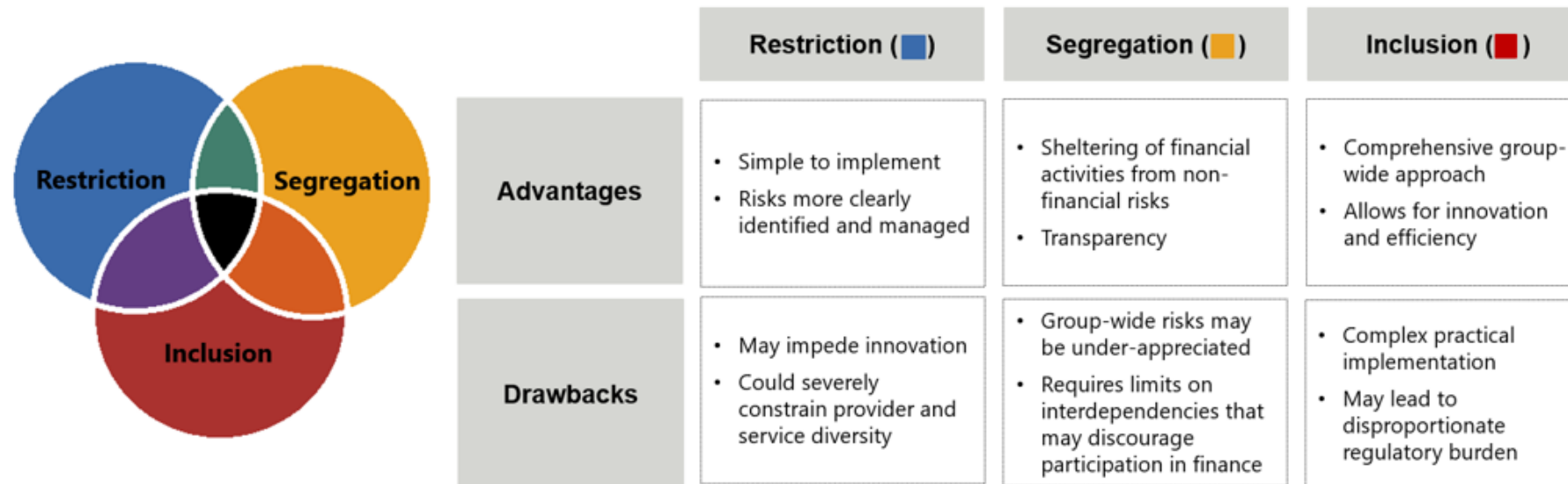
- From provision of financial services
 - Interdependencies and conflicts between financial and non-financial activities
 - Opaque partnerships with financial institutions
 - Participation in potentially disruptive digital-money related activities
- From provision of tech services to financial institutions
 - Critical role for operational resilience of financial sector
 - Systemic implications due to few providers
- From concentration dynamics
 - Impact on market contestability and tendency towards market dominance
 - Increased vulnerability of the financial system through excessive concentration

CURRENT REGULATORY APPROACHES

- Mostly a piece-meal approach
 - Developments in different policy domains
 - Focus on regulated financial subsidiaries (regulated on basis of sectoral regimes)
 - No true “group-wide” requirements
 - Few controls for interaction across legal entities
- Emerging regulation for some specific activities
 - Issuance and provision of services related to stablecoins
 - Provision of critical services to financial institutions (eg cloud)
- Emerging entity-based regulation in the area of competition

IN SEARCH OF A NEW FRAMEWORK: the need for entity-based rules

- Target interaction across all big tech's activities (Restoy (2021), Carstens et al (2022))
- For financial activities, choose between: i) restriction; ii) segregation and iii) consolidation



Source: FSI Occasional Paper (forthcoming).

- *Segregation* (with ring-fencing) is simpler but also more radical than *inclusion*.

IN SEARCH OF A NEW FRAMEWORK: inspiration from conglomerates

Comparison of the current regulatory regimes

		FHC (China)	FHC (EU)	FICO (EU)	MFHC (EU)	FHC (US)
Scope	Required subsidiaries to fall within scope	Bank	✓	✓ ⁱⁱ		
		Bank and insurance			✓	✓
		Other	✓ ⁱⁱⁱ			
	Thresholds	Size	✓ ^{iv}		✓ ^v	✓
		NFA ⁱ	✓	✓	✓	✓
Licensing and supervision	Licensing	✓	✓	✓		✓
	Consolidated supervisor	✓	✓	✓	✓	✓
Selected requirements	Consolidated prudential requirements	✓	✓	✓	✓	✓
	Intragroup financial transactions	✓ ^{vi}	✓	✓	✓	✓
	Non-financial intragroup interdependencies (data, IT systems)	✓ ^{vii}				
	Conduct of business (competition)	✓ ^{viii}	✓ ^{ix}			

Sources: Trial Measures, FHC, FICOD, CRR.

➤ Interaction across financial activities already regulated (Noble (2020), ESA (2022))

IN SEARCH OF A NEW FRAMEWORK: limits of current regulatory categories

- Focus on traditional financial activities (banks, insurance)
- Emphasis on prudential requirements
- Lack of sufficient controls over interaction between:
 - Non-financial activities (eg e-commerce)
 - Regulated financial activities (eg payments, deposit-taking)
 - Unregulated financial activities (eg lending, credit-scoring)

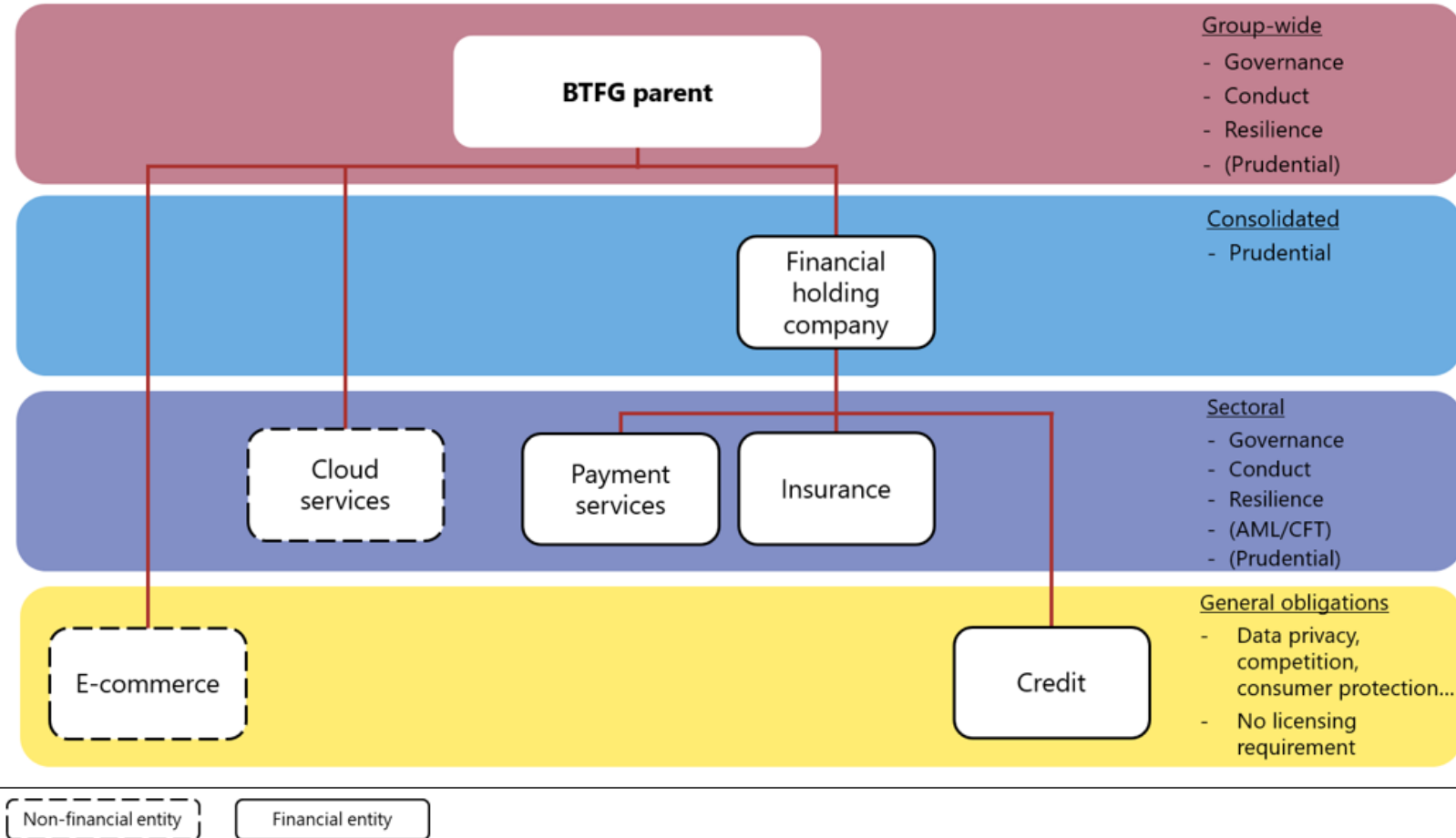
A NEW REGULATORY FRAMEWORK

The main elements of Big Tech Financial Group (BTFG) regulation

- Scope of application. What are “significant” financial activities?
- Regulatory architecture
 - Organisational structure
 - Home-host issues
- Actual group-wide requirements
 - Governance
 - Conduct of business (data, competitive behaviour, ethics)
 - Operational resilience
 - [Financial soundness]
- Supervisory regime

A NEW REGULATORY CATEGORY FOR BIG TECHS: regulatory architecture

BTFG group-structure and applicable regulation



Source: FSI Occasional Paper (forthcoming).

A NEW REGULATORY CATEGORY FOR BIG TECHS: group-wide requirements

Regulatory requirements for BTFGs

Governance	Conduct	Operational resilience	Financial soundness
<p>Group-wide corporate governance standards:</p> <ul style="list-style-type: none"> • Suitability of board members and senior management • Constraints on overlapping boards within BTFG • Transparency of organisational structure • Policies to identify conflicts of interest • Risk management culture • Internal interdependencies • Pricing policy for intragroup transactions 	<p>Group-wide conduct of business standards:</p> <ul style="list-style-type: none"> • Collection and use of client and user data • Sharing of data within group and external parties • Anticompetitive practices (<u>ex ante</u> rules) • Unethical, <u>illegal</u> or discriminatory misuse of platform 	<p>Group-wide operational resilience standards</p> <ul style="list-style-type: none"> • Mapping of intragroup interdependencies • Interdependencies between services offered to financial institutions and other big tech activities • Business continuity planning and testing • Disclosure to supervisors 	<p>Group-wide prudential requirements</p> <ul style="list-style-type: none"> • Capital requirements • Liquidity requirements • Group-wide capital and liquidity planning • Management of group-wide concentration risks and significant intra-group transactions
Requirements apply to all BTFGs.			
Requirements apply only to BTFGs that fall under existing financial-group categories (<u>eg</u> FHC or MFHC).			

Source: FSI Occasional Paper (forthcoming).

A NEW REGULATORY CATEGORY FOR BIG TECHS: supervisory approach

- Strong case for a single supervisor of group-wide requirements
- closely coordinated – via MoUs – with relevant non-financial regulators (data, competition....)
- and leading a “college” with sectoral supervisors of relevant financial subsidiaries (including local FHCs)

CONCLUSION

- Clear case to develop a specific regulatory regime for big techs with significant financial activities (BTFG).
- Two regulatory approaches could be envisaged: i) *segregation* (with ringfencing) of financial activities and ii) *inclusion* entailing specific group-wide requirements for big techs as a whole.
- Need to weigh effectiveness, intrusiveness and complexity.
- Anyway, clear need for international standards