

The Future of Fintech: The Regulatory Challenge Ahead

Kathryn Judge

There is a lot of hype around Fintech:

- “Digital Disruption: How FinTech is Forcing Banking to a Tipping Point” Citigroup
- “Good news – fintech could disrupt finance” Martin Wolf, FT
- “Why Fintech Is One of the Most Promising Industries of 2015” Inc.
- “The Opportunities of Digitizing Payments: How digitization of payments, transfers, and remittances contributes to the G20 goals of broad-based economic growth, financial inclusion, and women’s economic empowerment.” World Bank Development Research Group and others

There is growing investment in Fintech:

- “In 2015, the number of fintech companies in the United States and United Kingdom increased to more than 4,000, and investment in fintech companies since 2010 has surpassed \$24 billion worldwide.”
 - Supporting Responsible Innovation in the Federal Banking System: An OCC

There are market-based reasons that
much of the hype is likely to be
overstated.

Evolution of P2P is illustrative:

- The promise:
 - P2P lending will expand pool of eligible borrowers.
 - P2P lending will lead to short, direct intermediation chains.
 - P2P lending will lead to short, direct intermediation chains.
- The reality:
 - Individuals not very good at determining who deserves credit; access to credit depends on traditional criteria and most goes to persons who could get loan elsewhere.
 - The majority of capital comes from institutional investors, not individuals.
 - P2P loans increasingly embedded in long, complex intermediation chains.

There are market-based reasons that the industry may evolve into form that is more collaborative with, than disruptive of, established forms of financial intermediation:

- “In 2010, 60% of North American fintech investment dollars went to ventures that compete against traditional institutions, while 40% went to those that collaborate with them. In 2015, the ratio was reversed.” Accenture
- “It is difficult for fintechs - particularly in the US - to grow and scale on their own, so investments are shifting to fintechs that partner with rather than compete against traditional institutions.” Robert Gach, Accenture

Assuming there is disruptive potential, Fintech poses important regulatory challenge.

- Regulation has a first-order impact on the boundaries of modern financial firms.
 - Direct
 - Indirect
- Sitting on sidelines is not an option.

In many ways, classic financial regulatory challenge:

- Legitimate policy issues at stake
 - Protecting investors
 - Protecting borrowers
 - Access to credit and discrimination
 - What happens in the shadows can have first-order impact on health of regulated institutions and stability of system as a whole
- But reasons to be concerned about regulatory intervention
 - Regulatory capture
 - Intermediary influence

Evidence thus far – may be reason for concern

- OCC Innovation Initiative -- “Responsible Innovation”
- The Clearing House Comment Letter
 - “We ...commend the OCC’s willingness to evaluate and develop its own infrastructure and policies....”
 - “We believe that it is very important that activities and investments that ... are not currently subject to formal review and approval ...should not be vetted by the OCC’s proposed office.”
 - “[W]e believe it would be beneficial for the OCC to actively consult with the industry before setting prescriptive ... requirements by regulation, guidance, supervisory manuals, examination practices or other means.”
 - As the OCC points out in the White Paper, one of the competitive advantages that nonbank innovators enjoy over banks is their ability to move quickly to capitalize on new opportunities....We believe, however, that this ability also reflects the general absence of a comprehensive regulatory structure governing the activities of nonbank innovators, as well as the related absence of formalized corporate governance frameworks, particularly in the area of risk management.”

There is the potential for there to be something more at stake:

- Public remains disenchanted with financial firms and financial regulators.
- Part of the promise Fintech embodies is to displace established – and disliked – financial firms.
 - Appeal of P2P
 - Martin Wolf: “Why might one hope that ...’Fintech’ will transform these businesses? The answer, especially for banking, is that they are currently not done very well. Banking seems inefficient, costly, riddled with conflicts of interest, prone to unethical behaviour, and, not least, able to generate huge crises.”