Authority for Consumers & Markets

FinTech and competition

How to boost FinTech's contribution to effective competition in the financial sector?

June 2016

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Introduction

The Netherlands Authority for Consumers and Markets (ACM) creates opportunities and options for businesses and consumers. By fighting against unfair competition and making it easier for new entrants to enter markets, ACM improves competition. Competition leads to innovation and more choice for consumers. New players and technologies may have the potential to change the competitive landscape. ACM therefore strives to improve the likelihood that these new developments will have a positive and lasting impact on competition.

The financial sector is currently witnessing the emergence of technologies that can offer new and innovative financial services ('FinTech'). It has been widely recognized that FinTech may be an important driving force for competition, consumer choice and innovation in the market. However, it may also bring new risks for competition.

ACM is keen to help FinTech to reach its full potential. Engaging with parties involved with FinTech will enable ACM to focus its activities on what really matters for the further development of FinTech.

> If you would like to provide us with your thoughts on what ACM should focus on, please get in touch by sending an e-mail to FinTech@acm.nl.

FinTech and competition

ACM has done extensive research into competition in several markets in the financial sector. Although there are large differences within the sector, a picture that often emerges is that of an oligopoly with significant barriers to entry. For many financial services, a few large firms have the lion's share of the market. The studies have also shown that competition does not always work effectively in these markets. FinTech may have the potential to improve this.

There are many views on how FinTech will ultimately change the financial sector. This document is not about trying to pick the right 'long term' view of the future. In order to focus its activities, ACM is especially interested in barriers that prevent FinTech from reaching its full potential. This means that ACM pays special attention to barriers that hinder the development of FinTech. For example, certain behaviour of established market parties may undermine the chances of new entrants to successfully enter a market. There may also be risks involved with rapid technological change. Changing market structures may have adverse effects on competition and innovation.

ACM's role in FinTech

ACM enforces Dutch and EU competition law. Among other things, this includes detecting cartels and abuses of a dominant position. ACM can and has imposed large fines on parties involved in these practices. ACM receives a large number of signals concerning possible infringements of competition law. The choice of which cases to pursue is for an important part based on the impact of the possible infringement on consumers. This means that ACM would pursue a FinTech related case if it involves a significant harm to competition and hence consumers.

There are also other ways in which ACM may get involved to unlock FinTech's potential. For example, ACM could engage more actively in the national implementation of European regulation, such as the revised Payment Services Directive (PSD-2). In this role, ACM would try to make sure that the competition perspective stays in focus.

Another possibility would be for ACM to perform a market study. ACM has performed several market studies into competition in the financial sector. Most of these studies uncovered barriers to competition. Where appropriate, ACM made recommendations to lower these barriers. A good example is a study into barriers to entry in the Dutch retail banking sector that ACM performed in 2014. This study made a number of recommendations to the Minister of Finance on how to lower barriers for new entrants. ACM could perform a similar study to uncover possible barriers to competition in FinTech. This could again lead to concrete recommendations to policy makers, aimed at improving competition.

It should be clear that ACM focusses on improving competition by stimulating pro-competitive effects of FinTech, while trying to prevent possible risks FinTech may bring for competition. Other supervisory authorities may have a (slightly) different focus and objective, but ACM is convinced that cooperation among supervisory authorities will assist in reaching each of these objectives.

Factors that ACM is especially interested in

Many parties involved in FinTech are well aware of ACM's role and powers. However, other parties may not. To provide more guidance for the latter group, this section lists some hypothetical examples of factors where ACM may play a role. These are not the only factors that will determine the success or failure of FinTech. For example, regulatory barriers may also be important. These factors have not been included because they have already been well identified and/or do not directly require attention from ACM, but from government or other supervisory authorities.

There is an abundance of (economic) literature that identifies factors that either stimulate or hinder competition. This is not the place for an extensive overview of these factors. However, it may be useful to give an idea of typical factors that have an impact on competition. ACM has grouped these in three categories.

1. Anti-competitive behaviour of firms

Firms can try to defend or improve their position by engaging in anti-competitive behaviour. This should not be confused with normal pro-competitive behaviour (harm to *competitors*), which is a common and necessary element of a market economy. Anti-competitive behaviour leads to harm to *competition* and ultimately to *consumers*. There are a lot of different forms of anti-competitive behaviour. Two of the main examples are foreclosure and collusion.

Foreclosure means that a large firm tries to drive a competitor from a significant part of the market. This can be achieved by, e.g., refusing a competitor access to a necessary input, a refusal to deal with a competitor, setting predatory prices or bundling/tying products.

Collusion occurs when two or more firms engage in cooperative behaviour with the goal of improving their position to the detriment of competition and consumers. Collusion can be both explicit or tacit, but the effect on market outcome is basically the same.

Examples of anti-competitive behaviour in a FinTech context may be:

- Banks refuse FinTechs access to the bank account or transaction/customer data, e.g., by non-compliance with the goals of the PSD-2;
- 'BigTechs' such as Apple and Google and/or banks foreclose efficient financial services providers by leveraging their strong position in other markets;
- Stronger collaboration between new and existing market players leads to (tacit) collusion at the expense of consumers;
- Setting standards in a way that leads to potential foreclosure of new market players.

2. High concentration and entry barriers

It is generally accepted that a market that is characterised by high concentration and high entry barriers tends to be less competitive. In a highly concentrated market, one or a few firms supply a (very) large part of the market. When existing competitors or potential entrants are not capable to exert a competitive constraint on these large firms, this may lead to harm to competition and consumers. For example, capacity constraints can make it difficult for competitors to respond to a price increase of a large firm. Entry barriers, such as authorisation procedures and capital requirements, make the competitive constraint from potential entrants less effective.

Examples where FinTech may increase concentration or entry barriers in financial markets are:

- FinTech leads to markets in which economies of scale are so large that there is only room for one or two big players: the market 'tips' to dominant positions of, e.g., 'BigTechs' keeping smaller FinTechs out of the market;
- Market fragmentation causes dominant positions of (possibly relatively small) companies that have specialised in a niche;
- Existing players take over new 'maverick' entrants in order to prevent a change in the competitive landscape;
- Authorisation regimes favour existing players, thereby denying new players the possibility of constraining competition effectively.

3. Consumer inertia

A key driver of effective competition in a market is the consumer's ability to exercise choice. Consumers need access to information in order to compare different offerings and, once they have chosen the one that best satisfies their needs, they must be able to act on this choice. Furthermore, the threat of consumers switching to a competitor provides incentives for firms to improve the products and services they offer, for example by lowering prices, improving quality and investing in

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innovation and product development. Competition suffers when consumers do not exert this competitive constraint.

There can be a variety of reasons for this. Search costs make it more difficult for consumers to obtain sufficient information on the products that are offered. These costs will be higher when there are a lot of different products on the market and when transparency on product features is low. Switching costs occur when a consumer faces costs that are directly caused by his decision to change supplier. These costs can be avoided by sticking with the same supplier.

Examples of consumer inertia in a FinTech context are:

- An ever-increasing number of new services leaves large groups of consumers confused and unable to make an informed choice;
- BigTechs and/or banks successfully develop 'must-have' products and bundle them with other products;
- Firms try to 'lock in' clients with long term contracts.

Do you have input for ACM?

It is very useful for ACM to receive input of parties involved in FinTech. This will enable ACM to focus its activities on what really matters for the further development of FinTech.

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