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Innovation on a Grand Scale

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Introduction

I am delighted to be back here once again and thank you for having me. FinTech always offers new developments for me to talk about. Technology continues to make the headlines, as ever. It continues to shape not only the financial sector but almost every aspect of our lives.

My theme today will be scale: the scale of firms doing financial innovation and the scale of their projects. Many FinTech firms in recent years have been start-ups. But now we are seeing very large technology companies – the 'BigTechs' – entering financial services. This may bring benefits for consumers and markets, but also risks, as I will discuss shortly.

A financial technology that has yet to achieve scale is Distributed Ledger Technology, or DLT. Through our work on the topic at ESMA, we have monitored many proposed DLT projects in securities markets and the wider financial sector. But none of these projects operate at a global scale. This could change however, as BigTechs look to enter financial services. A recent high-profile development is the possibility of global stablecoins, which could in theory use DLT to provide payments outside the banking system for billions of consumers. The importance of these developments is reflected in this afternoon's agenda, where a number of distinguished speakers from the public and private sectors will discuss crypto-assets, stablecoins and how regulators and policymakers should respond.

If financial innovations unfold on a grand scale in the years ahead, with firms and projects operating across borders and economic sectors, this will pose new challenges for policymakers and regulators. Regulators will increasingly need to cooperate closely and take coordinated action at European level and internationally. A good example is the European Forum for Innovation Facilitators that the three ESAs and the European Commission launched last year.

On that note, I am delighted to be joined by colleagues from the other ESAs here today, underscoring our coordinated approach to innovation and digital finance.

So the theme of my remarks is the growing scale of financial technology and the firms involved, and what this means for regulation. I will start by outlining the trends we see around BigTech in finance. I will then turn to DLT, and to the possibility of global stablecoins as an area where BigTech and DLT may intersect.

BigTech financial services: trends and potential growth

Major technology firms, such as Alibaba, Amazon and Apple, are household names. They are truly vast and have grown with astonishing speed. A recent issue of *The Economist* highlighted that the five largest US technology firms added nearly 2 trillion dollars in market cap in 2019.[1] The services that BigTechs offer – think of online marketplaces, smartphones, search engines and social media – are now an integral part of many people's lives.

Many of these huge firms now offer some financial services. China-based firms offer a wider range of services than US-based firms. But there is potential for BigTech financial services to grow in Europe and the US, where BigTechs are looking to collaborate with incumbents. For example, Apple and Goldman Sachs have together launched a credit card and have signalled that they would like to expand into asset management.

In other regions too, BigTechs are entering finance. The Argentina-based online marketplace platform Mercado Libre has a core business similar to eBay. In recent years it has diversified into payments, credit and other financial services including asset management.

A striking example of BigTech financial services in China is the Yu'e Bao ('leftover treasure') money market fund, launched by Ant Financial in 2013. The fund makes use of surplus cash in customers' online accounts. Within just four years, it became the world's largest money market fund, with over EUR 200bn in AuM. Following this breath-taking growth, the fund has seen periods of outflows since Chinese authorities introduced restrictions on online provision of money market funds in 2018, citing systemic risk concerns. Nonetheless, rivals such as Tencent have recently launched similar products.

BigTechs have the potential to win market share in financial services because they enjoy competitive advantages such as economies of scale, vast customer networks, access to cheap

[1] The Economist, "How to make sense of the latest tech surge", 20 February 2020

funding and proprietary data that powers personalised services. They may have different core services, but all use the same key raw material – Big Data. Like smaller FinTech firms, the entry of BigTechs into finance is smoothed by the wider digitalisation of the financial sector. Firms have 'digital proximity' to clients, reducing the advantage of established branch networks as people manage their finances online at the touch of a button.

Benefits and risks of BigTech in finance

BigTech firms may use data to offer tailored services. This is a familiar idea from other lines of business. For instance, you may receive online advertising for a holiday destination based on your searches for local hotels, your social media posts or recent holiday-related online purchases. In a similar way, firms may offer savings products based on one's personal finances. Setting aside the privacy concerns for one moment, tailored offerings may in principle benefit existing consumers. BigTechs may also promote financial inclusion among some people who are already familiar with using online services. Furthermore, economies of scale and advanced technology mean that BigTechs may drive down costs.

A risk, however, is that even if competition in certain financial services increases at first, it may later suffer as BigTechs grow market share. Switching provider may be less convenient if financial services are integrated with other lines of business. In other words, BigTechs may, after successful entry and growth, achieve a 'gatekeeping' position. And they may use personal data to extract more surplus from consumers through segmented pricing.

Privacy and data rights are a major concern, especially in light of the apparently illicit use of personal data by some firms in recent years. A single firm may be able to learn and infer a huge amount about people's lives and personal circumstances. Integrating financial services into online platforms increases even further the sensitivity of such information.

Although financial inclusion may be a benefit in some cases, there is a risk of exclusion in others. For example, reduced information asymmetry between provider and client for products such as insurance or credit may reduce prices for some consumers, but exclude others altogether. And people less inclined to use digital technology may lose out. Finally, a business model operating across economic sectors may raise concentration risk. An operational incident that originates in one platform service offered by a BigTech firm could have a large impact on other lines of business, including financial services.

BigTechs in finance may bring benefits such as efficiency gains and personalised services, but also risks. Their data-based business model raises issues around privacy and could facilitate

price discrimination. And if competition suffers in the long run, consumers may lose out and markets may face concentration risk.

Distributed Ledger Technology (DLT)

I now turn to DLT, an area that has promised much but has not yet delivered projects on a grand scale. For example, DLT is being considered to upgrade legacy systems of trading venues and banks. But we have not yet seen a DLT-based system emerge to handle any major component of the global financial system. As yet, there is no 'killer app' for DLT

Will the arrival of BigTechs on the scene allow DLT to scale up? Just like in the days of the early internet, when several of today's BigTechs were still start-ups, we must wait to see how the market unfolds.

ESMA started to look at DLT as early as 2015, when virtual currencies such as Bitcoin appeared on our radar. We published a 2017 report on the potential benefits and risks of the technology applied to securities markets. We highlighted the need to address money laundering, security, privacy and governance issues. We also highlighted possible competition issues. Regulators globally have noted similar concerns that any global stablecoin would need to address before its launch.

More recently, a full crypto-asset ecosystem emerged, involving trading platforms and providers of custody-type services. This prompted us to assess the applicability and suitability of current EU securities rules to crypto-assets. We then published Advice to the EU institutions in January 2019, alongside Advice from the EBA.[2]

Building on this Advice, in December 2019 the European Commission launched a consultation on an EU framework for crypto-assets. The consultation highlights two sets of issues. The first is the important risks, including to investor protection, that are left unaddressed where crypto-assets fall outside of the regulated area. The second is the challenges in applying certain existing rules to those crypto-assets that qualify as financial instruments or e-money.

In my view, the EU needs a common, holistic approach to the regulation and supervision of crypto-assets. We need a regime that ensures the right level of protection without stifling

[2] ESMA Advice: Initial Coin Offerings and Crypto-Assets, 22 January 2019; EBA Report with Advice for the European Commission on Crypto-Assets , 22 January 2019.

innovation. I look forward to seeing how the Commission will proceed after the consultation concludes.

Global stablecoins: BigTech meets DLT

This brings me to the topic of global stablecoins. I expect you are already familiar with the topic, which has attracted much attention since Facebook announced its proposed Libra project last year. A global stablecoin would provide a new digital 'coin' pegged to fiat currencies, to facilitate payment and other financial services globally.

I need to start off with an important caveat. We are yet to see a detailed proposal for a global stablecoin, let alone see one operate in practice. The Libra White Paper only sets out the broad features of a proposal for such a project, which may evolve in response to regulators' concerns. But even broad proposals in this area suggest there is potential for radical BigTech projects in future in some form.

A possible benefit from global stablecoins is to make cross-border payments easier, cheaper and quicker. They may also promote financial inclusion, especially in developing markets.

FinTech firms already offer apps for cross-border payments at near interbank rates. But a difference with potential BigTech projects is scale, as some of these firms count their users in the billions. And a distinctive feature is that a global stablecoin such as Libra would be a 'currency' of its own – although it may not meet the legal definition. This raises a host of challenges for regulators, not least risks to financial stability and the international monetary system, as highlighted in a recent report by the G7.[3] A detailed regulatory response would depend on the precise features of a global stablecoin.

Our Advice made clear that crypto-assets require a case-by-case assessment to determine whether they fall within the scope of EU law. Some parts of global stablecoins such as Libra could function like a bank, whereas others could be similar to a fund. Even where these components do not meet the relevant legal definitions, they should be regulated in line with the risks they raise.

[3] G7 Working Group on Stablecoins, October 2019, 'Investigating the Impact of Global Stablecoins'.

A coordinated approach

To conclude, we may soon see financial innovation on a grand scale. BigTechs operate not only across borders but across economic sectors, and their entry into the financial sector may change profoundly the risks and benefits around financial innovation.

BigTechs may allow DLT applications to reach critical mass, but we will have to see. Regulators need to stay alert to these new developments and make sure that our rules remain fit for purpose. This involves a risk-based approach to innovation, whatever the technology or the business model.

Now more than ever, we need a coordinated approach to digital finance at European and global level. Last April, the Commission and the ESAs launched the European Forum for Innovation Facilitators to exchange information and share knowledge from across innovation hubs and sandboxes in our Member States. Initiatives of this kind will become ever more valuable as we monitor innovative activity all the way from small-scale firms up to the largest banking firms and new entrants.