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FCA EXPLORES COMPETITION IMPACTS OF "BIG TECH" ENTERING RETAIL FINANCIAL SERVICES

The FCA has published a Discussion Paper looking at potential benefits and risks to competition of "Big Tech" entering payments, deposits, consumer credit and insurance.

On 25 October 2022, the UK Financial Conduct Authority ("**FCA**") published a Discussion Paper on the potential competition impacts of "Big Tech" firms' entry and expansion in retail financial services. The FCA's analysis focusses on four "Big Tech" firms: Google (Alphabet), Apple, Facebook (Meta) and Amazon as each has already entered financial services in the UK or globally. For each of payments, deposits, consumer credit and insurance, the FCA sets out:

- Steps "Big Tech" firms have already taken to enter the market;
- How "Big Tech" firms could enter or expand in the market; and
- Potential competition benefits and risks resulting from "Big Tech" entry.

The purpose of the Discussion Paper is to facilitate an industry-wide discussion and inform the FCA's approach to regulating financial services markets in the digital age.[1] The FCA does not propose any regulatory or policy changes, but will publish a Feedback Statement in the first half of 2023 setting out how it will develop its regulatory approach in response to the feedback received.

Although the FCA focusses on the UK, it refers to "Big Tech" entry in other jurisdictions, and its approach may influence competition authorities abroad.

Key issues

- The FCA explores potential benefits and risks to competition of "Big Tech" entry and expansion into retail financial services
- Payments, deposits, consumer credit and insurance are under the spotlight
- Stakeholders can respond to the questions the FCA has outlined in the Discussion Paper until 15 January 2023
- The FCA is not proposing regulatory changes at this stage however it plans to publish a Feedback Statement in the first half of 2023

BACKGROUND

The FCA's focus on "Big Tech" firms' entry and expansion in retail financial services comes at a time where large technology firms face greater regulatory scrutiny in the UK and globally.

In the UK, the government has concluded a consultation into a new pro-competition regime which aims to address the competition challenges in digital markets. In preparation for the new regime, a separate Digital Markets Unit has been established within the Competition and Markets Authority ("**CMA**"), and there are indications that the CMA, together with other UK regulators, are scrutinising the role of technology firms within the financial services sector more closely. For example:

[1] The Discussion Paper does not focus on wholesale financial markets or technology services provided by "Big Tech" firms to financial firms such as cloud services.

- In March 2021, the CMA opened an investigation into Apple's App Store, including the App Store rules mandating the exclusive use by app developers of Apple's own in-app purchasing mechanism. In June 2022, the CMA opened an investigation into Google's Play Store rules on similar grounds.
- In July 2022, the FCA, Bank of England and the Prudential Regulation Authority jointly published a Discussion Paper proposing statutory powers to regulate so-called "critical third parties", which provide third-party services as an input to financial services, under the Financial Services and Markets Bill. This may involve consultation between UK financial regulators and the CMA on the designation of a service supplier as a critical third party.

On 1st November 2022 the Digital Markets Act ("**DMA**") entered into force in the European Union. The DMA's stated aim is to promote fair and contestable digital markets in the EU economy and will introduce *ex ante* prohibitions and obligations on digital companies designated as "gatekeepers". Other regulatory initiatives for the digital sector, including ones touching upon payments, are being developed in the US, Australia, South Korea and Japan in relation to merger control, app store rules and transparency obligations.

OTHER INITIATIVES

Competition and consumer protection agencies have started to assess the entry of "Big Tech" into retail financial services:

- The European Commission ("**Commission**") announced on 2 May 2022 that it had sent a Statement of Objections to Apple over practices regarding Apple Pay. The Commission preliminarily found that Apple abused its dominant position in markets for mobile wallets on iOS devices by limiting access by third party developers to technology used for contactless payments (Near-Field Communication technology). The Australian Competition and Consumer Commission is also conducting an investigation regarding Apple Pay.
- In August 2019, the Commission sent questionnaires to participants involved in Facebook's Libra currency which was later abandoned following scrutiny from financial services regulators.
- In October 2021, the US Consumer Financial Protection Bureau ordered six firms that operate payment services to provide information about their business practices, including their data collection and use, their policies for removing individuals or businesses from their platforms, and their policies and practices for adhering to key consumer protections like addressing disputes and errors.

UK's retail financial services under the competition spotlight

Scrutiny of retail financial services markets by courts and competition authorities includes, amongst others:

- CMA's Retail Banking Market Investigation
- FCA Strategic Review of Retail Banking Business Models
- Competition Appeal Tribunal's decision on the Compare the Market case
- FCA's General Insurance Pricing Practices Market Study
- FCA's Credit Information Market Study
- PSR issued its first infringement decision

FOUR RETAIL FINANCIAL SERVICES SECTORS IN FOCUS

In its Discussion Paper, the FCA has focused on four retail sectors: payments, deposit-taking, consumer credit and insurance. The FCA has chosen these sectors as it deems them to be the most important to consumers and the sectors which could be most affected by "Big Tech" firms' entry and expansion.

PAYMENTS

The FCA considers that payments have been the natural starting point for "Big Tech" firms entering financial services internationally. In the UK, entry in this sector has primarily focused on the provision of add-on services using existing payments infrastructure, such as through the use of digital wallets in smart mobile and wearable devices.

Potential scenarios for "Big Tech" entry and expansion:

1) "Big Tech" firms could intermediate beyond their existing offering (mainly digital wallets) to provide more services across the card schemes.
2) "Big Tech" could facilitate the adoption of non-card payment systems to compete with card schemes directly e.g. by using digital wallets to facilitate payments through a non-card payment channel.
3) "Big Tech" firms could widen the scope beyond retail payment products through digital wallets, such as by offering peer-to-peer transfers.

Potential competition benefits:

The FCA stated that arguably the sector has become more contestable due to the existence of "Big Tech" firms that may have the ability to overcome scale and network barriers to entry. "Big Tech" firms could also incentivise lower prices, higher quality and innovation from scheme operators. This is due to their scale, expertise and countervailing bargaining power.

Potential competition concerns:

The FCA would be concerned if the market evolved such that a "Big Tech" firm acquired market power, for example becoming a gatekeeper for in-person or online transactions. This could allow the "Big Tech" firm to engage in exploitative conduct such as setting high prices to business partners and reducing quality. The "Big Tech" firm could also engage in exclusionary conduct, with the intention of preventing competitors from entering, growing or remaining in the payments space. The FCA highlighted that there are "unpredictable factors" that will affect whether a "Big Tech" firm attains such market power.

DEPOSIT-TAKING

In its Discussion Paper, the FCA looks at deposit-taking broadly, including personal current accounts, savings accounts and e-money accounts. The FCA states that "Big Tech" firms are not widely active in the UK deposit-taking sector but considers potential scenarios in which "Big Tech" firms could enter this area.

Potential scenarios for "Big Tech" entry and expansion:

1) Entering as a distributor through a partnership with a deposit-taking or e-money issuing firm (i.e. providing the interface and customer relationship for consumer to access financial services provided by a financial services firm). Alternatively, it could offer an open platform or marketplace matching the "Big Tech" firm's user base with a range of competing deposit taking institutions.
2) Entering as an e-money institution, providing an e-money account directly to consumers which may appear to consumers as being similar to a personal current account.
3) Entering by offering personal current accounts directly after gaining relevant regulatory permissions.

Potential competition benefits:

"Big Tech" entry, or the threat of it, has the potential to increase the intensity of competition, putting competitive pressure on incumbents. "Big Tech" firms could use their user base, access to capital, data and multi-product offering to overcome barriers to entry. "Big Tech" platforms or marketplaces, allowing users to compare alternative accounts or providers, could put competitive pressure on existing providers to compete for customers.

Potential competition concerns:

The FCA would become concerned if the market evolved such that a "Big Tech" firm gained market power by controlling or becoming a gatekeeper to a significant share of consumers' deposits. If "Big Tech" firms had market power and excluded digital challengers from the market, traditional retail banks could be left to serve high-cost customers through their branch networks, possibly resulting in financial exclusion of consumers, and ultimately, exit of firms from the market. There could also be liquidity risks to banks and building societies where platforms are able to move substantial deposits at the same time.

CONSUMER CREDIT

As part of its assessment, the FCA has taken into account credit-related activities and consumer-facing credit products. Credit-related regulated activities include entering into regulated credit agreements as a lender, credit broking, providing credit information services and credit references. The FCA highlights that entry into this sector in the UK has frequently been through partnerships, more often as brokers than lenders.

Potential scenarios for "Big Tech" entry and expansion:

1) Entering as a credit broker, introducing consumers to lenders e.g., through an exclusive partnership with one lender (or a very small range of lenders) or as a marketplace for search offering consumers choice from a range of sources.
2) Entering as credit lenders, directly offering Buy Now Pay Later or alternative credit products to facilitate purchases on own platforms, taking advantage of user data and purchase history as a simple form of credit reference, and potentially expanding to allow purchases at third-party merchants and retailers.
3) Entering as a credit reference agency. "Big Tech" firms have data on behaviour and past purchases that may enable them to create a credit score, to use in-house or sell to lenders.

Potential competition benefits:

According to the FCA, "Big Tech" firms could help consumers make more effective decisions as well as lower search and switching costs, hence putting competitive pressure on incumbents. Further, if "Big Tech" firms' competitive advantages create cost efficiencies, these could result in lowering interest rates or improving fees. The FCA suggests that "Big Tech" firms' access to data and machine learning capabilities may result in innovative risk and affordability models, improved efficiency, and the promotion of financial inclusion.

Potential competition concerns:

The FCA highlights that it would be concerned if the market evolved such that a "Big Tech" firm gained market power. For instance, the FCA considers that a "Big Tech" firm creating a credit broking "marketplace" could self-preference using choice architecture, promoting its preferred credit provider to lower-risk consumers. The FCA would also be concerned if a "Big Tech" firm were able to leverage its market share in mobile ecosystems to promote its own Buy Now Pay Later offering as a default or prominent option in that mobile ecosystem, by integrating it with its other core activities. Finally, the FCA suggests that if a "Big Tech" firm's data became a key input to credit reference agencies then it could gain a competitive advantage in the credit information market by restricting access to this data and technology.

INSURANCE

The FCA looked at "Big Tech" entry into insurance generally. However, it highlights that entry of "Big Tech" firms in home insurance, health insurance, and motor insurance may be facilitated through data that "Big Tech" firms gather through smart devices in the home or wearables.

Potential scenarios for "Big Tech" entry and expansion:

1) Entering as an intermediary, including as a marketplace, price comparison website or broker.
2) Entering as a provider of third-party data or business services (e.g. as a provider of consumer data to third parties).
3) Entering as a direct insurer, responsible for underwriting and executing insurance contracts (the FCA considers this unlikely)

Potential competition benefits:

"Big Tech" firms' entry as an intermediary could lead to better access to predictive technologies and analytics, creating spillover effects on incumbent insurance providers as they can reduce the costs of organising and executing insurance contracts. They may also create new origination channels for newer forms of insurance, such as on demand insurance. Predictive technologies also help to improve matching between consumers and insurers, providing policies and insurance products that better meet the needs of the consumer.

Potential competition concerns:

The FCA states that it would be concerned if "Big Tech" firms were to acquire a competitive advantage due to their volume of data, multi-product offerings and access to large user bases. For example, the FCA suggests that the combination of large user bases and access to predictive technologies with specific user data could be a significant competitive advantage in personalising consumer recommendations, including potentially giving the opportunity for exploitative conduct. This could include offering data at high prices and creating margin squeeze (in cases where "Big Tech" operates as an intermediary or data provider).

Conclusion

The FCA sees several themes regarding "Big Tech" entry into these four retail financial services sectors:

- **Further growth and expansion could arise from strong complementarities** – banking, deposits and consumer credit are already offered by banks as complementary products and "Big Tech" firms may also be able to introduce new complementary offerings. In the long run, entry in one market will create opportunities for expansion into neighbouring, complementary markets.
- **Partnerships will be the preferred route for "Big Tech" entry in financial services in the short term** – partnering with incumbents who assume greater regulatory responsibilities is likely to continue to be the preferred entry strategy.
- **Acquisitions and organic growth in the future** – in the medium-to-longer term, "Big Tech" firms may choose to enter financial services more directly by attempting to capture more of the value. This could be done through acquisitions or bringing more of the value chain activities in-house.
- **Increased competitive pressure in the sector** – increased operational and technological efficiencies could lead to lower prices and better-quality services in the retail financial space. "Big Tech" firms may be able to use their large customer base to improved access for currently underserved consumers. Entry by "Big Tech" firms may incentivise incumbents to embrace digital technologies and digital distribution themselves.
- **Potential for longer-term market power** – the FCA does not see "Big Tech" firms as currently having market power in the retail financial services space. However, the FCA conceives of a scenario where these firms might be able to gain market power by using their complementary product offering to attract customers and then hypothetically lock them in or by restricting rivals' access to data.

Next Steps

Stakeholders can respond to the questions the FCA has outlined in the Discussion Paper until 15 January 2023. Although the FCA is not proposing regulatory changes at this stage, it plans to publish a Feedback Statement in the first half of 2023 setting out its response to the feedback received from industry participants and how it will shape its regulatory approach.

The FCA will hold an online panel event to launch the Discussion Paper on 28th November 2022 including a lawyer from Clifford Chance speaking on the panel. There will also be sector specific roundtable discussions on 6th and 7th December 2022.

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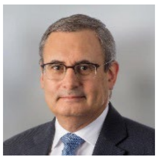

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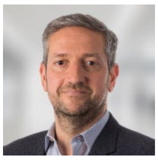

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