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Policy Position

Big Tech
Closing the Blind Spot in Europe‘s Financial Market Rules

22 September 2021

#BigTech
#FinancialStability
#Supervision

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The technology giants Google, Apple, Facebook, Amazon and Microsoft are on the rise, recently also in the financial services business. This poses new challenges not only for competition regulators and consumer protection agencies, but also for financial market supervisors. The European financial market rules have a blind spot with regard to big tech and this endangers financial market stability. To prevent technology giants from flying under the radar of financial supervision, Sebastian Mack argues in this policy position for making group supervision of financial conglomerates fit for the digital age.

Google, Apple, Facebook, Amazon and Microsoft are becoming larger parts of our everyday lives. For some time now, the big tech companies have also been pushing into the market for financial services. As this poses new dangers for the financial system, the Bank for International Settlements (BIS) has now called on regulators to take action. Rightly so, as – also in Europe – financial market regulation is not fit for the 21st century. The technology giants are flying under the radar of financial supervision, although they are handling ever-larger parts of payment transactions. The European rules for the supervision of financial conglomerates therefore urgently need a general overhaul.

Three Risks for Financial Stability

As suppliers, business partners and, increasingly, competitors of traditional financial institutions, big tech companies could shake up the banking sector. Since they have not been adequately regulated and supervised so far, this poses at least three risks to the financial system – in addition to concerns about competition and data protection.

First, for their digital transformation, major banks increasingly rely on digital storage space that can be accessed from anywhere in the world. Three quarters of these “public clouds“ are provided by Microsoft, Amazon and Google. A serious disruption of the technology giants would have severe consequences for the banks' ability to function. In other words, when Microsoft coughs, Commerzbank has the flu.

Second, big tech companies increasingly sell products together with established banks. Apple has developed its own credit card in cooperation with Goldman Sachs and Mastercard, while Google offers a bank account together with Citigroup. If the technology companies run into financial difficulties in their core business – for example, due to reputational damage from data leaks or as a result of a break-up by antitrust authorities – this could also impact business with cooperating banks

Third, big tech corporations are increasingly offering financial services themselves: Google, Apple, Facebook and Amazon have set up their own payment systems, with Amazon also granting loans to merchants. The technology groups are thus weakening the already low profitability of European banks and could bring down some established institutions in the long run. Above all, however, the technology giants themselves could shake the financial system if they handle large parts of the payment business and were to fail suddenly.

Taking Action Before it is too Late

How quickly big tech companies can become systemically important is evident in China. There, WeChat Pay and Alipay have a firm grip on the mobile payments market with a share of 94%. In Germany, Amazon Pay is already as popular as Giropay, the online payment service offered by German banks and savings banks. Google and Apple Pay are right behind and lying in wait. The technology giants owe their enormous growth potential to so-called network effects: their platforms provide them with access to a huge number of customers and their data. When financial services are just a click away, they may spread rapidly. In order to prevent material risks from building up outside of financial supervision, technology groups must be adequately regulated and supervised.

Activity-Based Rules are Inappropriate

Big tech groups that only provide individual financial services are not required to have a banking licence in Europe. They are subject to the relevant sectoral rules. However, these activity-based rules are not adequate for the diverse risks of technology groups such as Amazon in two respects: First, they mostly only stipulate requirements for business conduct or consumer protection, while not imposing comprehensive requirements on capital, liquidity and risk management. Second, sector-specific regulations always only apply to the subsidiary offering the respective service and do not take into account the risks of the group as a whole. For conglomerates, the European Directive on Financial Conglomerates does provide for additional group supervision. Nonetheless, it only covers "regulated entities" such as banks, insurance companies or investment firms and only applies if at least one company is active in the insurance sector. While the 2002 directive fits classic financial conglomerates such as AXA or Allianz, it comes to nothing for Google & Co.

Group Supervision of Big Tech

To address the European financial market regulation's blind spot on big tech, it is time to make group supervision fit for the digital age. To this end, the Financial Conglomerates Directive must be improved in three respects. First, the definition of a “regulated entity“ must be broadened so that major financial service providers are also supervised. Second, all possible combinations of financial activities must be covered; groups without insurance business must also be supervised. And third, group supervision must not ignore any risks arising from the group‘s non-financial business. In its strategy for digital finance, the EU Commission announced a year ago that it wanted to review the rules for financial conglomerates. In view of the risks big tech poses to financial stability, nothing less than a general overhaul will do.

Gefördert durch:

Bundesministerium der Finanzen

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