**FinTech and market structure in financial services Market Developments and Financial Stability Implications (Reading Article 1)**

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**READING NOTES**

For the **Third** **Reading Assignment**, I select **reading-article-1[[1]](#footnote-1)** from the reading list to read. After completing the reading, I **summarize** this article and record **reading notes** as required by the assignment.

***SUMMARY.***

**This article focuses on considering changes in market structure in financial services brought about by technological innovations and exploring the potential impacts of these developments on financial stability.** Technological innovations (such as cloud computing and FinTech credit) are increasing market access, the range of product offerings, and convenience while lowering costs to clients. At the same time, the universe of financial service providers is materially altered by a number of new entrants into the financial services space. These could in turn affect the concentration, contestability, and composition of financial services, with both potential benefits and risks for financial stability.

Some specific drivers could influence the market structure of the financial sector in key ways. **On the supply side**, technological developments, including the use of API, smartphone technology, and cloud computing, have dramatically changed the form of financial services, prompting not only the emergence of providers of bank-like services such as FinTech credit but also facilitating the entry of large, well-established technology firms into financial services (‘BigTech’). The changes in financial regulation may also impact the development of the relevant companies. **On the demand side**, customer expectations are considerably changing due to the digitization of commerce, demographic factors, as well as economic development and convergence factors.

The specific impact that the above drivers are having on the market structure can be divided into three parts by the areas. (i) FinTech firms: The relationship between most incumbent financial institutions and FinTech firms appears to be largely complementary and cooperative in nature. But FinTech credit is growing rapidly, which might have negative effects on the profitability of some traditional institutions. (ii) BigTech firms: Thanks to the large, established customer networks, and name recognition, BigTech firms could achieve scale very quickly and greater market share in financial services, which represent a source of increased competition for incumbent financial institutions. (iii) Third-party service providers: Reliance by financial institutions on third-party data service providers will increase going forward, cloud services may reduce operational risk at the individual firm level while posing new risks and challenges for the financial system as a whole.

Overall, changes in market structure can create a more efficient and resilient financial system, while bringing new implications for financial stability such as legal risk and cyber risk. There might be the potential for new, large players to provide financial services from outside the traditional financial sectors, which might make the issues become more acute. So, it’s important for authorities to regularly assess stability risks and bear in mind the comparability of the functions performed, the level and types of risks involved, and the size of those activities! (434 words)

In order to understand the article summary more clearly, I have drawn a framework figure of the article as shown in **Figure 1**.



**Figure 1.** Framework of Reading Article 1.

***NOTE.***

As per the course schedule, the course topic for this Thursday just happened to be “Applications of Blockchain Technologies in the Financial Industry”, so I chose this article to read, in order to explore the impact of FinTech on the market as a whole, and to further explore its potential role in financial stability.

As mentioned in the summary above, in this article, the author detailed the benefits and risks of technology innovation in the provision of financial services in three sections, FinTech firms, BigTech firms, and third-party service providers. Echoing what Mr. Wang said in class, technological innovations, driven by emerging technologies such as blockchain and cloud computing, have had a greater impact on market structure, especially in concentration, contestability, and composition. This article was written in 2019, five years past, when the Palm Bank, various shopping and lending such as JD Credit, and other booming, larger crowded the profit space of traditional financial institutions. At the same time, they also carry a certain amount of control risk.

**QUIZ QUESTIONS AND ANSWERS**

***Q1.*** *What are the key drivers of changes in market structure due to FinTech innovations?*

***Answer:***

The drivers that could influence the market structure of the financial sector in key ways can be divided into the supply and demand side:

* ***On the supply side,*** these include the use of application programming interfaces (APIs) over the internet, cloud computing, and changes in consumer behavior driven by smart-phone technology. Besides, some elements of financial regulation, such as licensing requirements and competition aspects in regulation, are also relevant drivers.
* ***On the demand side,*** the changing customer expectations, as a result of the digitization of commerce, demographic factors, are the main driver

***Q2.*** *What are the impacts of BigTech firms on financial services?*

***Answer:***

In some jurisdictions, large, well-established technology firms have recently entered financial services markets. These firms can provide financial services as part of the products or services that they normally provide. BigTech firms can partner with incumbents and act as distributors of their payment, lending, and insurance products (which is being significantly simplified through APIs). Alternatively, their access to a large quantity of client data could allow them to carry out risk assessments, which could underpin the provision of credit.

In general, new BigTech players could offer lower-cost (or even free) services, since they could use the data obtained through these services for a variety of businesses. This in turn could also have a range of effects on existing markets.

***Q3.*** *What is cloud computation, and how do firms utilize cloud computing?*

***Answer:***

Cloud computing refers to the practice of using a network of remote servers, typically accessed over the Internet, for the provision of IT services. Cloud computing offers advantages such as economies of scale, flexibility, operational efficiencies, and cost-effectiveness.

Presently, financial institutions mainly use the cloud for such operations as customer relationship management, human resources, and financial accounting. In the future, institutions might run such services as consumer payments, credit scoring, statements, and billings for asset managers’ basic current account functions on the cloud (which has been the truth). Authorities, including financial services authorities and self-regulatory entities, are also using cloud computing and related services in some cases.

***Q4.*** *What are the impacts of the increasing reliance on third-party service providers for financial services?*

***Answer:***

Financial institutions rely on third party service providers for data provision, physical connectivity, and cloud services. The reliance of traditional financial institutions and FinTech firms on third-party service providers may increase over time. Systemic operational and cyber security risks may arise if systemically important institutions or markets do not appropriately manage risks associated with third party outsourcing at the firm level. At the same time, this development offers commercial benefits to banks, rather than market competition. There appear likely to be strong commercial pressures for banks to engage increasingly with these services, though potentially constrained by banks’ own risk management or supervisory restrictions.

***Q5.*** *How do we face the implications of market structure developments?*

***Answer:***

The issues, such as the impact of heightened competition on profitability and lending standards, as well as increasing cyber risk, may become more acute due to the following three reasons:

* The raft of new technologies introduced in the past few years, and the impetus provided by open banking could also change the dynamics of competition quickly.
* Changes in business models may occur more quickly than in the past as BigTech companies actively and successfully push into traditional financial services.
* The technology focus of both new providers and incumbents – particularly where they are closely integrated into firms’ operations – may entail a new dimension of operational risks.

More generally, as discussed in earlier FSB reports, there is the potential for new, large players to provide financial services from outside the traditional financial sector.

So, it’s important for authorities to regularly assess stability risks and bear in mind the comparability of the functions performed, the level and types of risks involved, and the size of those activities. At the same time, the relevant institutions should further explore third-party dependencies in cloud services and single point of failure risks.

1. https://www.fsb.org/uploads/P140219.pdf [↑](#footnote-ref-1)