Opinion **Larry Summers' blog**

What fintech is going to do to banking

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I had a keynote conversation last week with my friend Markus Brunnermaier on fintech and the future of finance at a conference he held at Princeton. Here is the video. Markus got me to think about a number of different aspects of fintech that I hadn't fully considered before. Some of the main points I tried to make were:

- Fintech is ultimately about taking away frictions. I gave as examples of frictions that are kind of shocking in the 21st century — the huge premiums people pay for title insurance every time they refinance a mortgage, the inability of the big banks to enable even major private bank customers automatically to pay down their credit line whenever they have cash inflows and the $40bn-plus in credit and debit card interchange each year.
- I guessed that there was a 25 or 30 per cent chance that 10 years from now, there was about a 25 per cent chance that there would be a fintech company with the kind of $250bn market cap that some big American banks have. I do not expect that in the foreseeable future fintech will have the kind of existential impact on banks that Netflix has had on Blockbuster. But I do think in some areas fintech companies are likely to have the kind of effect Skype has had on the big telephone companies — forcing drastic reductions in pricing and profit margins on some key products.
- I surprised Markus a bit by being sceptical of the idea that one of the big tech players like Apple, Google, Facebook and Amazon would also become a big player in financial services. I noted the traditional American aversion to combinations of banking and commerce and also that I thought privacy rules would preclude their using their massive data troves to drive lending activity.
- I was quite serene about the impact of fintech on financial stability. In general, it seems to me that prevailing understandings of financial crises put too much emphasis on financial innovation and too little on age-old rapid oscillation between greed and fear, on real estate lending and real estate bubbles, on excessive leverage especially related to implicit government guarantees, and on illiquidity phenomena.
- By providing for faster settlements, more transparency, and diversification, fintech is likely to have as many stabilising as destabilising effects.
- If the large banks of today are not as large five or 10 years from now, I think it is more likely to be because of bad lending, heavy regulation or market pressures to break up because the whole is valued less than the sum of the parts than because of disruption from fintech. I say this because much of what fintech does depends on the banking system and because I doubt that over this horizon banks can be completely disrupted.
- I argued that financial regulation should be directed at functions and at institutions, not at particular financial instruments, noting that most instruments could be synthesised in multiple ways and suggesting that all might have similar impacts.

My overall conclusion was that fintech is likely to make a substantial contribution by removing frictions. Policymakers should be slow to accede to demands from incumbents for heavy regulation of new fintech entrants. At the same time, they should ensure that when fintech companies succeed, it is on the basis of genuine efficiencies not because of regulatory avoidance.