A two-sided affair: banks and tech firms in banking[1]

Executive summary

The widespread adoption of digital technology is fundamentally altering the way customers interact with the financial system. Digital advancements have opened avenues for tech firms to broaden their presence in the financial sector, stimulating demand for innovative methods of payment, borrowing and saving. Today, with just a few taps on a mobile device, access to banking services can be executed swiftly and seamlessly, often without a bank in sight from the customer's perspective.

Tech firms, including big techs and fintechs, have come to deliver various financial services that are typically provided by banks. These services allow users to access payment, credit or depository services ("banking services"). They primarily cater to consumers and small businesses and often feature unique functionalities due to their distinct access points, setting them apart from those offered by traditional banks.

Tech firms generally obtain a licence or form partnerships with banks to deliver banking services. Observations from a sample of big techs and large fintechs suggest that a given firm typically uses a mix of both, which may be related to its motivation for providing specific banking services, the availability of options at the jurisdictional level, and the disparities in requirements for licences and partnerships.

Tech firms have traditionally provided banks with back-end services, but now they are also entering front-end partnerships with banks. In back-end partnerships, a non-bank provides technology services to a bank, such as cloud computing. Meanwhile, in front-end partnership arrangements, the bank provides its infrastructure (such as the ability to access the payment systems) to operationalise the non-bank's offering of financial services, while the non-bank engages directly with the customer.

Big techs' offering of depository products through bank partnerships has been relatively limited so far, with deposit-taking partnerships more commonly found between fintechs and banks. In deposit-taking partnerships, tech firms facilitate the delivery of depository products directly to their customers via digital platforms. Although the tech firm typically manages the customer interface, the deposit itself is held on the bank's balance sheet.

There are numerous instances of lending partnerships between banks and tech firms. In a direct lending partnership, borrowers can access credit through a tech firm's digital platform, with banks and tech firms taking on a variety of roles in the credit origination process. Another variant of a lending partnership is a credit referral arrangement where the tech firm acts as a broker to a bank, introducing eligible customers to specific lending products, often after conducting a pre-screening analysis.

The nature of payment partnerships is highly diverse. In order to provide payment-related services, tech firms frequently rely on payment infrastructures which are typically only accessible to banks. However, in some countries, non-bank entities, including tech firms, can directly access payment systems or even operate their own systems. Digital wallets are a prominent type of payment partnership.

The increasing involvement of tech firms in banking services has transformed the structure of value chains within the banking sector. Traditionally, the banking business model operates on an

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integrated, vertical value chain. However, the entry of tech firms, either through partnerships with banks or by obtaining monoline licences, has given rise to a new expanded and more distributed banking value chain. In this new value chain, banks are pushed further away from the customer relationship; however, they typically remain involved in at least one layer of the value chain.

While the expanded and more distributed value chain presents opportunities, it also poses challenges for banks and supervisors. This new approach could broaden consumer access to new markets and enhance efficiency by allowing firms to specialise in areas where they have a competitive edge. However, as more entities participate in delivering a single product or service, this can heighten prudential and conduct risks. Specifically, front-end partnership arrangements can introduce operational risks, compliance risks (including in relation to anti-money laundering and countering the financing of terrorism (AML/CFT)) and reputational risks, which may differ depending on the specific banking service provided. There may also be concerns around data privacy and security, consumer protection, large tech firms' negotiating power vis-à-vis banks and banks' business model sustainability. Additionally, as responsibilities and risks become dispersed among numerous entities within the value chain, the regulatory boundaries become increasingly blurred, posing novel challenges for day-to-day supervision.

In most jurisdictions, however, there are no direct regulatory restrictions for tech firms to partner with banks to provide banking services. By standard practice, regulators primarily manage potential risks from such partnerships by regulating and supervising the bank partners. The general principle is that banks' partnerships with third parties do not diminish their responsibility to ensure activities are performed in compliance with regulatory requirements. Thus, supervisory oversight over tech firms is typically indirect and limited.

In some jurisdictions, authorities have implemented a blend of measures to manage partnerships between tech firms and banks. These include initiatives to: (i) gather more information; (ii) adjust prudential/conduct requirements and/or clarify supervisory expectations in different policy areas, including operational resilience, financial soundness, consumer protection, AML/CFT and competition; and (iii) review the regulatory perimeter and supervisory approach.

Big techs present unique challenges in partnerships due to their size, negotiating power and banks' potential oversight limitations. If front-end partnerships become more prevalent, big techs' role in financial services could grow, necessitating careful monitoring of the multifaceted role big techs play, both as providers of financial services and as service providers to financial institutions. In addition, the emergence of new corporate structures may require specific entity-based rules for big tech operations in finance to address risks not covered by current frameworks.

Tech firms' growth and evolution in the banking sector has implications for the banking value chain that may warrant additional policy responses. The complexity of partnerships and expansion of tech firms, particularly big techs, in delivering banking services across multiple jurisdictions without consolidated oversight, limits visibility for regulators. Over time, if left unchecked, this could have significant implications for public trust, a fundamental pillar for the soundness of the banking system, and consequently financial stability. Therefore, additional actions at the national level, supported by international policy cooperation, could be warranted.