Opinion 21-A-05 of April 29, 2021

on the sector of new technologies applied to payment activities

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BANK / INSURANCE

DIGITAL

Presentation of the notice

Summary

The *Autorité* decided to conduct a sector-specific inquiry on its own initiative on 13 January 2020, with a view to assessing the competitive situation in the sector of new technologies applied to financial activities, and to payments in particular. The investigation conducted in this context has led to the following findings by the *Autorité*.

In recent years, thanks to technological innovations and specific regulatory amendments made at the European level (in particular the adoption of the first and second Directives on payment services), the supply side of the payments sector has undergone significant changes, which has resulted in a new market dynamic. This dynamic, which can be seen in the entry of non-bank actors into the payments sector, is being driven by two very different categories of actors. Firstly, those that can be grouped under the "FinTech" banner, which brings together a wide range of entities with very different profiles and business models: these can be small innovative start-ups, with no pre-existing business, some of which are growing at the European or even international level (N26, for example), but also well-established players from other business sectors with a well-developed customer base, including Orange and Carrefour. The other significant element of disruption in the sector is the rapid and large-scale arrival of the major digital actors, collectively referred to as "Big Tech"[1]. This category

includes both GAFAM[2], in Europe and the United States in particular, and BATX [3], which have acquired strong positions in Asia and are starting to expand in Europe and the United States. This dynamic is also reflected in the strategies implemented by the traditional banking actors to adapt to the digitisation of payment services.

The transformation of the payments sector is primarily reflected in the emergence of a range of new services, payment initiation channels and alternative payment methods in recent years. Payment initiation services and account information services were created in the wake of the second Payment Services Directive ("PSD2")[4]. New payment initiation channels have emerged, including contactless payment via bank card, mobile phone and connected smartwatch, set against the backdrop of a consolidation of remote payments on the internet. Moreover, payment via facial recognition could become a reality in Europe in the future. Finally, "alternative payment methods" are now recognised by the Banque de France, which include crypto-assets as well as stablecoins, the second generation of crypto-assets. Various initiatives to develop these stablecoins have recently been launched, including the initiative by the bank JP Morgan to launch the JPM Coin, which is pegged to the US dollar, and the initiative by Association Diem, in which Facebook participates through its subsidiary Novi, to issue a single-currency stablecoin in the initial phase, the "Diem Dollar", which could be pegged to the US dollar.

These different developments are based on recent technologies. While the sector has always been characterised by major technological breakthroughs, often intra-sectoral, such as the automation of transaction processing in real-time or the development of smart cards as a means of payment, it is now incorporating two technologies, cloud computing and blockchain, which, although not specific to this sector, are likely to bring about profound and lasting changes to the way it operates.

Cloud services, which comprise among others outsourcing solutions for computing and data storage and transfer, are becoming an indispensable service for many actors in the sector, both new entrants and established names, due to the flexibility and performance offered by these services. Currently used

primarily in the financial sector to facilitate crypto-assets transactions, blockchain is also a particularly promising technology, and is expected to drive the development of innovative services, improve the security of payments, reduce their cost and accelerate cross-border transactions.

The new market dynamic resulting from these changes are characterised not only by the arrival of FinTech and Big Tech in the sector, but also by how the traditional banking groups, which are also directly and actively involved in the current developments, have adapted.

The traditional banking actors in France are committed to the evolution of the payments sector and are implementing a range of complementary strategies: they are investing in FinTech directly, via equity stakes, in order to internalise specific functions offered by the latter, create synergies or conquer new markets; they are also entering into cooperation or partnership agreements with new non-banking actors, in particular Big Tech; and they are continuing to invest intensively in R&D, to enhance their services.

The agreements concluded between banks and FinTech allow the former to take advantage of the agility and innovation of the latter, while FinTech can capitalise on the banks' reputation, distribution channels, customer base and capacity to handle regulatory constraints. The agreements concluded between banks and Big Tech allow banks to offer their customers specific services such as *Apple Pay*, *Google Pay* or *Samsung Pay*, for example. Finally, agreements concluded at the national level between banking groups have led to the emergence of new actors such as Paylib and Lyf Pay, which offer among others contactless payment services. An agreement at European level, the European Payment Initiative (EPI), aims to create a pan-European payment system that could connect banks to each other without using the current networks such as Visa and MasterCard.

Banks' investments in R&D include incubators for payments start-ups, to accelerate their digital transition and expand their customer base (for example, to reach younger customers or be active in new services).

The *Autorité* has analysed the impact of these developments on the competitive balance of the payments sector, by examining the competitive relationship of the products and services in question (substitutability or complementarity) and identifying barriers to entry and expansion, as well as the competitive advantages enjoyed by the different categories of actors active in the sector, before formulating specific points of attention.

First, as regards the products and services in question, the *Autorité* has observed that some markets in the payments sector are two-sided in nature. This is especially the case of card payments, which today are the leading means of payment in terms of number of transactions, and which some of the new entrants, including platforms such as Google and Apple, rely on to offer their services. The sector is also characterised by a high level of dynamism, which is reflected in the emergence of a wide variety of innovative products and services, often integrated with each other or combined with pre-existing products or services to become ancillary to them, or ceasing to exist as a stand-alone service. This dynamism can make it difficult to precisely pinpoint, on a lasting basis, the scope of the products or services brought to market, and therefore the nature of the competitive relationship between these products and services. These two characteristics may render market definition a particularly complex task, especially in the context of prospective merger analysis.

Next, as regards barriers to entry and expansion, the *Autorité* has identified regulatory and economic barriers, as well as barriers to accessing given infrastructures and data.

The sector is indeed characterised by substantial regulation, which varies according to the services marketed and pursues multiple objectives: for example, the stability of the monetary and financial system, anti-money laundering and terrorist financing. Furthermore, certain activities fall outside the scope of the French monetary and financial code (Code monétaire et financier) and are therefore not subject to the relevant oversight (this is the case, for example, for services that are seemingly payment services but do not necessarily fall under the above-mentioned Code, such as those that allow contactless payment by mobile phone, like *Apple Pay*).

The economic barriers are reflected in the existence of direct and indirect network externalities, particularly in certain two-sided markets, as well as experience economies (high costs of gaining brand recognition and the trust of customers) and economies of scale (significant fixed costs borne by banking actors relating to physical branch networks and IT systems). The existence of these barriers helps explain the way FinTech decide to enter the sector, with some of them relying on pre-existing distribution networks (e.g. Orange Bank or Nickel) and using new technologies, including cloud services for IT needs, for instance.

The other barriers identified in the context of this opinion concern the following two situations.

Firstly, the opening or closure of effective access to the NFC (near field communication) antenna of smartphones has a real impact on the ability of the actors who have developed contactless mobile payment solutions based on NFC technology, which is the most widely used in France, to offer their services on smartphones equipped with these antennas.

Secondly, it can be seen from the statements made by certain actors during the investigation for this opinion that the various APIs developed by the account-servicing payment service providers ("ASPSPs"), including the banks in particular, in the context of the PSD2, are still not fully operational in France. According to these statements, this situation, as well as the obligatory redirection imposed by ASPSPs on their customers so as to allow their strong authentication when they use payment initiation services or account information services, would be likely to hinder the development of payment initiation service providers and account information service providers.

Finally, with regard to the competitive advantages enjoyed by the various categories of actors in the sector, banks have several advantages, on account of their historical position. They have unrivalled experience in mastering compliance with the various applicable regulations, and enjoy an excellent reputation in terms of security and protection of their clients' data, at a time when the practices of some of major digital players in this area are being called into question. In addition, thanks to their solid customer bases, their business

volumes allow them to have some of the lowest unit processing costs when it comes to their payment services. They can also easily pool these services with the other services they offer. Banks also have a good knowledge of their customers' habits, thanks to the volume and quality of their historical data, on which some new entrants depend in order to offer their services. Their decades of experience in the design and operational management of payment solutions, as well as their ability to defend their interests before governments, and their financial strength, are also significant competitive advantages.

Unlike traditional banking actors, FinTech, including neobanks, have lower fixed costs, which constitutes a competitive advantage. In effect, they bear neither the costs of maintaining interbank infrastructures, nor the costs resulting from the physical networks of banks. Nor are they bound by the legacy of old and cumbersome IT systems, built on sometimes obsolete technologies. This means FinTech can be agile, responding quickly to the specific needs in the day-to-day lives of consumers, and positioning themselves in niche markets. What is more, they have expertise in simplifying the "customer experience", which can lead to the creation of payment solutions that are easy to use and adapted to the new habits of the users of these services.

Finally, the major digital actors have significant competitive advantages, even though their entry into the payments sector is much more recent. First of all, they have a vast user community from their core businesses, on which they can draw in order to develop rapidly in the payment sector, as Apple and Amazon have done, respectively, through *Apple Pay* and *Amazon Pay*. Furthermore, they have access to reams of data on the users of their non-financial services, an advantage that they can combine with their expertise in new technologies, such as artificial intelligence and algorithmic tools, to process and analyse the said data. Thanks to these unrivalled strengths, they can develop the capacity to assess the financial health of their users more effectively and tailor their offerings to the latter's preferences or needs, including by estimating their maximum willingness to pay.

Big Tech also benefits from considerable financial strength, which allows them to make substantial investments in various new technologies that facilitate the

development of innovative payment solutions. Thanks to the technical mastery of their ecosystems, structured for the most part around platforms, into which their payment solutions are integrated, the major digital actors are able to offer a highly fluid and effective "customer experience" that can be hardly replicated by their competitors. Moreover, due to economies of scope, they face lower marginal costs than, for example, traditional banking actors, which enhances their capacity to offer their payment solutions to consumers free of charge. At the same time, they can derive substantial advantages from their payment service partners or providers, including commissions, because of the unavoidable nature of their services. Finally, the major digital actors enjoy, with some individual specificities, a brand image and reputation which, in the context of their payment solutions, are likely to foster a loyalty from some users, in particular young ones, owing to the advantages offered by their ecosystem.

In light of these elements, the *Autorité* highlights the following points of attention.

Firstly, the *Autorité* identified several competition-related risks relating to certain competitive advantages enjoyed by Big Tech and the banks on the one hand, and the use of blockchain technology on the other.

The data collected by Big Tech in the context of their core business activities could give them a significant advantage in the payments industry and, conversely, the data collected via the payment services they offer could allow them to make their respective platforms more attractive. Moreover, beyond the possible barriers that may arise from the actual access to the NFC antennas of smartphones, certain practices relating to mobile contactless payment solutions, including the pre-installation of features in some phones or the introduction of ergonomic shortcuts which facilitate access to a given feature, could present risks for competition, for example if they result in consumers being excluded from a given ecosystem, or they could be considered, more generally, as abuses of a dominant position.

In the context of the implementation of the rules laid down in the PSD2 and Commission Delegated Regulation 2018/389[5], the investigation shows that a certain vigilance is advisable with regard to the conduct of ASPSPs, due to their holding of payment account data accessible online and, above all, to the

conditions under which they are made available, and to ensure in particular that it does not hinder the development of activities by payment initiation service providers and account information service providers.

The competitive risks that may arise from the use of blockchain technology, which are not unique to the payments sector but may materialise within it, may fall under the rules prohibiting anti-competitive agreements and abuses of a dominant position, and may be caused by the actors controlling the access to the blockchain, the users of the blockchain or the 'miners'.

Secondly, the *Autorité* notes that while the current developments will enhance the range of products and services on offer and improve their quality and diversity, while exerting pressure on prices to the benefit of consumers, they are also likely to lead to a profound change in the way the sector currently operates, in particular by possibly calling into question the "universal banking model", which allows certain services to be offered, such as cheque cashing and cash deposits, which would likely be "unprofitable" if offered in isolation.

To conclude, while a scenario in which FinTech would break away completely from the banking system by creating their own infrastructure seems unlikely today, it appears that, without having the experience of banks in the payments sector, BigTech master, or even control, certain innovative technologies which could, in the future, play a decisive role in the service chain. Their presence in the payments sector could therefore be strengthened, in particular through the conclusion of new partnerships with banking actors.

There is therefore a risk that traditional banking actors will find themselves confined to operative tasks involving significant fixed costs (regulatory burdens, physical network, payment infrastructures), while being marginalised in the value distribution chain.

[1] The term "Big Tech" refers to "giant digital services and data platforms based mainly in the United States and China" (see Banque de France, "Payments and market infrastructures in the digital era", report, January 2021, page 4, link).

[2] Google, Amazon, Facebook, Apple and Microsoft.

[3] Baidu, Alibaba, Tencent and Xiaomi.

[4] Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC, OJ No L 337, 23.12.2015, pages 35-127
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[5] Commission Delegated Regulation (EU) 2018/389 of 27 November 2017 supplementing Directive (EU) 2015/2366 of the European Parliament and of the Council with regard to regulatory technical standards for strong customer authentication and common and secure open standards of communication, OJ No. L 69, 13.3.2018, pages 23-43.

This summary is strictly for informative purpose. Only the full text of the opinion in French prevails.

Information about the notice

Sector Inquiry	yes
Origin of the referral	Autorité de la concurrence (autosaisine)

Read

Full text of the opinion (in French)
2.23 MB

Full text of the opinion (English)
2.49 MB

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