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Antitrust in the Financial Sector

#1 Fireside chat with Brian Brooks

Webinar - 6 April 2021*

> "Will the U.S. regulatory system (and the antitrust system in particular) keep up with the market or will we continue fetishizing deposits as the proxy for market share?"

Brian Brooks
Former Acting Comptroller of the Currency
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Richard Taffet

Richard Taffet introduced the discussion by outlining that though Brian Brooks is not an antitrust lawyer, his perspective as a global leader in financial services will be very insightful for the antitrust community. He added that a seismic revolution is ongoing in the use of technology in banking and finance: this revolution arises from the growing presence of alternative to traditional banks (*e.g.* fintech, alternative currencies).

Brian Brooks

Brian Brooks started by pointing that he believes this evolution has taken longer to develop in the US than in other parts of the world. In the US, for a long time, it was believed that banks offered a unique combination of three activities under one roof: a depository that also engages in payment processes and makes loans. This vision was reflected in the antitrust approach to the sector –in merger and acquisitions for instance. In concrete terms, this means that enforcers in the US still measure bank competition based on deposit shares in a local geographic market. The rest of the world, however, has moved on from this concept: it has integrated the notions of e-money, open banking and non-depository actors that compete with banks in financial services. The influence of these innovations is such that it affects price and power on the whole chain of value all the way down to consumer prices. Mr. Brooks argued that, by failing to integrate these innovations, US enforcers still act as they did in 1980 where a bank's market power could be assessed using deposit-taking. Talking about a seismic moment in the evolution of banking, it seems that two megatrends are changing the way consumers expect financial services.

The first megatrend can be described as "unbundling": this means that the three above-mentioned services (deposit taking, payments and lending) are no longer delivered in a bundle under one roof, but rather on a specialized

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basis. Internet merchants for instance stopped using banks for their payment processes: they tend to use various tech companies such as Stripe or Paypal. Borrowers, on the other hand, do not consider banks as their first lender of choice and turn to nonbank marketplace lenders. The most recent data from 2019 shows that 38% of consumer loans are made by fintech firms when 28% are made by banks. Considering these changes, one can ask: will the U.S. regulatory system (and the antitrust system in particular) keep up with the market or will we continue fetishizing deposits as the proxy for market share? The second megatrend is decentralization, which may be described as the financial equivalent of the changes that information went through in the 1990s. With online information, one no longer had to rely of intermediaries such as post offices or libraries and could send and receive information 24 hours a day from anywhere in the world. Blockchain is the major innovation which allowed the building of Internet networks for financial transactions. Mr. Brooks pointed out that unbundling is changing what a bank is and decentralization is changing the way finance is delivered to people – US antitrust law has yet to adapt to these changes if it is to ensure that the US remain a competitive marketplace.

Richard Taffet followed up by asking Mr. Brooks about the reaction of traditional banks to these changes, and the strategies nonbanks use to enter unbundled features. He also wondered whether the market is growing overall.

Mr. Brooks believes that traditional banks react on four different levels. First, they oppose new entrants, notably by fighting against fintech charters. This relates to the debate as to whether the US bank regulator has the authority to charter non-depositories as national banks. The OCC has said, two administrations ago that it should be able to charter national banks if they offer lending or payment services, even if they do not take deposits. The largest incumbents and their trade associations have vigorously opposed the idea that new financial companies could get the same bank charter they have. Major incumbents believe actors such as Stripe cannot be considered as banks because they are not subject to the regulatory obligations that traditional banks have on their deposits-mostly the Community Reinvestment Act (“CRA”). This argument seems out of point: CRA does not apply to Strip simply because it does not take deposits. On a different level, an interesting alliance has arisen between big banks and state regulators to prevent national bank charters to be granted to non-depository actors -state regulators seeking to protect their revenue stream from regulatory assessments. However, some banks see opportunity in the growth of some fintech startups -online lending companies like SoFi and Avant do rely on partnerships with banks. As banks originate the credit marketed by online lenders, they can extend their balance sheets and use the sale of the loan to originate the next loan. In the end, banks dislike competition but like the balance sheet leverage that fintech brings about. The same schizophrenia can be observed in banks attitude towards cryptocurrencies. Although banks have acknowledged the size and value of the crypto market, they have not yet engaged in competing with crypto exchanges in connecting to public blockchains and rather remain reluctant to invest in novelty. This explains why fintech is such an efficient competitor and why antitrust policy needs to rethink product market definition out of the box of deposits. Competition is now active in all areas where new platforms offer bank services and steal market shares from incumbents.

Mr. Taffet reflected on an opinion piece Mr. Brooks wrote in the Wall Street Journal advocating for national bank charters for fintechs – and more generally for fintech regulations similar to those of banks. He asked to what extent regulatory obligations are being imposed on fintechs that are chartered nationally. Mr. Brooks answered that risk-based regulation is the appropriate way to regulate. As innovation arises, the government watches for associated risk and acts accordingly. But the same risk should also justify the same regulation: for instance, Stripe being a monoline payments company, it processes payments the same way Bank of America does. It would therefore make sense to apply the same payments regulation to both of them, but not to apply deposit and lending regulations to Strip as it does not engage in either activity. A different question is whether traditional banks model may turn out to be inefficient, as investor returns, and consumers are moving towards specialized platforms.

Mr. Taffet then alluded to the CRA, and to the new rules the OCC adopted within its frame in the summer of 2021. The Fed also seems to wonder whether the CRA should be updated to make fintechs play a more significant role in communities. Brian Brooks answered that the CRA is part of a foundational canon of the civil rights law. It represents a consensus that traditional banks strike with communities. Since federally chartered banks enjoyed a lower funding cost than other businesses and government insurance, the counterpart what that they had to reinvest at least part of the deposits in their community of origin. But many fintech companies

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Richard Taffet
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do not take deposits and are not getting a government-subsidized cost of funds. Financial inclusion should remain a major goal but submitting all fintechs to the CRA is not necessary the way to achieve it. Many fintechs thrive because traditional banks do not serve low and moderate-income people very well. Those fintechs that offer a competitive alternative to these people could argue that this is their financial inclusion metric. CRA, in the end, is a specific rule designed to compensate the low cost of funds a depository bank enjoys, and it should not be considered as the ultimate standard for the whole financial industry.

Richard Taffet moved the discussion to the applications of these evolutions in the field of antitrust law. As they challenge preexisting notions, should fintechs encourage lawyers and enforcers to come up with new frameworks on relevant markets and market power? The Department of Justice("DOJ") has challenged several mergers in the financial sector -for instance in *Visa/Plaid.* These challenges are an opportunity to debate new definitions – and to move the focus away from deposits. Mr. Brooks believes that the US used to have antiquated definitions in both product market and geographic market (the latter being based on shares of deposits in a city or a Metropolitan Statistical Area "MSA"). In an Internet-enabled world, both deposits and MSAs become irrelevant. In 1982, an article by E. Gerald Corrigan asked: *"Are banks special?"*, in a context where capital markets products began competing with bank loans. What is it about a bank that makes it special? First, depository and non-depository banks do not appear to be competing in the same market. To simplify, it is possible to say that the three core banking activities are deposit-taking, lending and payment. Payment, for instance, used to be provided by banks only (via cash and deposits, then via credit cards)- nowadays Bank of America's subsidiary Square provides payments hardware and processes, but it is not active in the two other "core banking" activities. If it were to be acquired by Walmart for instance, how would antitrust implications be approached? It seems that the product market here is payment processing. Regarding the geographic market, measures used to be made based on local deposits. Local markets, however, make virtually no sense anymore: what matters to consumers is not geographic proximity but rather rate and insurance limits. In reality, these markets are unbounded -and European enforcers have already acknowledged that. Covid-19 accelerated this movement.

Reflecting on *Visa/Plaid*, one can argue that it was a vertical case (which may seem unusual). Furthermore, it was about potential future competition. The idea was that Plaid (a data Application Programming Interface) was contemplating building a debit payment system that may compete with Visa later on. Visa had made unfortunate comments about the acquisition, overtly trying to take out a future competitor. But the context of this case makes it hard to consider it a big precedent -Mr. Brooke does not believe it is, but rather than antitrust in the industry will still be focused on horizontal competition.

Mr. Taffet then brought up the issue of data, and the influence it might have on market power analysis. Mr. Brooks indicated that financial institutions are discovering that the business they are in boils down to monetizing data. Lending money is about credit modelling, and credit modeling is data mining and forecasting. The same goes for marketing and payments -the best operator will be the best at collecting data and learning valuable lessons from it. In *Visa/Plaid*, major synergies could be expected from the combination of the data acquisition skills from Plaid with the large financial database from Visa. But figuring out how to measure market power from data sets is not an easy task. Mr. Taffet pointed out that recent decisions seem to lean towards effects-based analysis and theories of harm.

Mr. Taffet then mentioned the Fair Access Rule initiative (initiated by the OCC and then abandoned by the current administration), which seems to have inspired a bill pending in the Senate. This rule aimed at ensuring that decisions on loans are based on individual risk rather than broad principles. Mr. Brooks explained that this rule was elaborated in a context where the six biggest banks in the US engaged in de-platforming a wide range of politically sensitive organizations. Although this practice would not have been regarded as an issue if there were ready substitutes and low entry barriers, such was not the case. The OCC based itself on its "fair access to financial services" mandate to engage in an antitrust analysis of the practice. Following this analysis -largely irrigated by the essential facilities doctrine-, it put forward a simple rule forcing banks with substantial market power to offer services to all clients except those who are untenable as clients because of specific risk factors.

Following a question from Mr. Taffet about the definition of market power in such cases, Mr. Brooks underlined that the more specialized your business is, the fewer alternatives you will have in terms of lending – and even though assets were used as a proxy to assess market power, relevant banks were still granted opportunities to prove that they did not have substantial market power, just like they would in a merger context. When asked about predictions for the industry, Mr. Brooks explained that he believes big banks will still be around, as will community banks. Mid-size banks however cannot rely on the same scales as big banks or on the same loyalty as community banks, and they may therefore be forced to specialize on certain activities. Crypto networks will also become more available and big banks are likely to connect more and more to it. ■