Digital disruptors at the gate: Does FinTech lending affect bank market power and stability?

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Discussion by Marina Cernov for EBA Research Workshop 2023

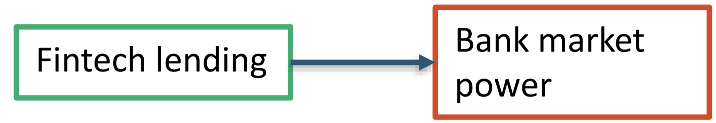
* The views expressed are those of the discussant and do not necessarily represent the official position of the EBA

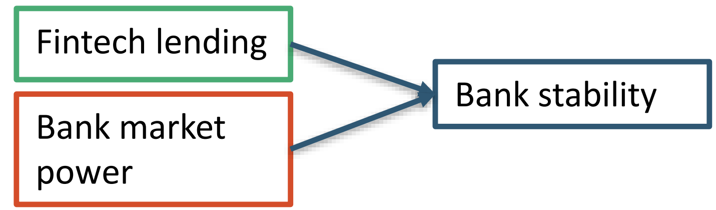
Summary of the paper

- RESEARCH QUESTION: What is the impact of fintech lending on bank market power and bank stability?
- IMPORTANT CONTRIBUTIONS OF THIS PAPER:
  - Impact of new business models on the incumbent banks, particularly on their stability and therefore stability of the banking system
  - New data (FinTech lending volumes of a sample of 79 countries 2013 – 2019)
  - Extensive literature review underpinning the narrative and causality
  - Explores impact of institutional quality on the effect of Fintech lending on bank market power and stability
  - Explores bank market power as channel by which Fintech lending affects bank stability

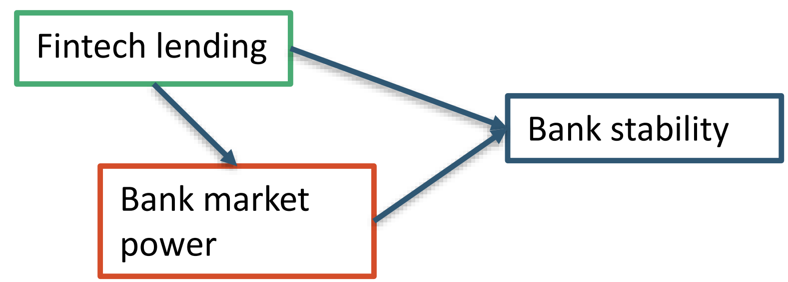
Main findings

- Using several specifications of LS regressions, the paper shows a strong relationship between increase Fintech lending and lower bank market power, and lower bank stability





- This relationship is reinforced where the positive relationship between market power and bank stability is considered as an intermediary mechanism (2SLS)



- The relationship holds even when specific characteristics of the regulatory and legal environment of the banking sector are taken into account:
  - Importance of institutional quality to dampen the negative effect of Fintech lending on bank market power and stability

Model and implications

Impact of Fintech lending on bank market power and bank stability:

- **Bank market power: LERNER index** --> inverse proxy for bank competition, measures the capacity of a bank to set a price P (interest rate) above its marginal cost MC
- **Bank stability: ZSCORE** --> (ROA + equity/assets)/stdev (ROA) (inversly correlated to probability of bank insolvency)

One of the main challenges of the paper is to prove that this relationship is causal, due to the endogeneity issues:

- Unmeasured terms (e.g. openness of societies to innovation)

- Reverse causality (e.g. bank market power and stability → extent of fintech lending)

In order to address the endogeneity:

- legal and regulatory environment considered

- country-level analysis

- Instrumental variable for Fintech lending (Rural population!!)

Comments

- Some model choices need better, more structured explanations:
    - Why *fin free* and *conc* was added to the mechanism regression but not to other regressions?
    - How does country-level analysis addresses endogeneity? (mentioned in conclusion, but not explained in the body)
- Economic impact: Delta Fintech lending is the move from 25th to 75th percentile
    - How was it calculated? Could the impact be different by bank type or by country?
    - Also depends on the distribution: Fintech lending varies a lot across countries. Within the same year, the distribution across countries can be quite substantial (data on this could be presented).
- Overall, given the extended information provided, some choices are not well explained, or their purpose is not always clear.

Policy implications and further extensions

Very relevant for policy makers:

→Importance of appropriate mechanism to promote banks stability

→Greater regulation of Fintech activities

→Importance of institutional quality

More discussion needed on:

→monitoring of fintech lending increase and its entrance in the more traditional banking market – data quality and availability

Extensions:

→ Explore the channel of selection bias of borrowers: Comparison of quality of borrowers, CR assessment process (fintech vs traditional banking)

→ Fintech lending by Business model type (P2P, Balance sheet lending, Invoice trading) → will impact the type of borrowers and therefore the impact on banks

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