Fintech's red flags

Summary

Myriam Vander Stichele

Why raise red flags about fintech?

All around the world, people are increasingly using their phones or other mobile devices for payments and other personal financial activities. The digitalised provision of specific financial services is referred to as "fintech" and makes use of innovative software and technologies, mobile devices, the Internet and various other technologies. Fintech has brought about new business models and is claimed to be causing a paradigm shift. However, citizens are hardly aware of the possible hazards for their finances and privacy, and for the wider economy and society.

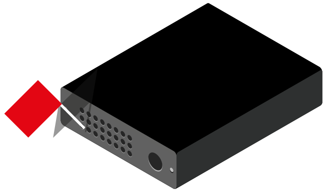
In order to inform civil society in an accessible way about fintech-associated risks and harmful practices and the need to address them, a SOMO publication provides an overview of fintech's 'red flags'. This briefing paper summarises the hazards, risks, harms, and negative impacts arising from fintech, identified as 'red flags' in the publication. Added to SOMO's Fintech's red flags publication is a glossary that explains some of the technicalities.

The fintech industry in short

The term fintech is applied to all kind of financial services ranging from payments, lending and other banking activities, to insurance coverage, investment industry operations, and processes in the crypto-currency world. The three main businesses that operate fintech are big tech companies, specialised fintech companies ('fintechs'), and the finance industry.

Fintech's red flags

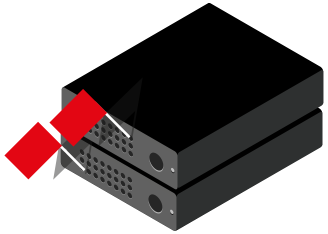
The risks, hazards and abusive practices of fintech applications can be characterised as follows.



1.
More financial inclusion and exclusion?

The expansion of numerous online, mobile and digital payment, saving and credit applications are claimed to have improved access for many people excluded from the formal banking sector. However, exclusion from financial services persists and expands to those without the mobile tools, digital skills or identification systems needed for online access. Certain fintechs have affected access to finance by discriminating based on new kinds of online data or new software that replicates and sometimes amplifies existing discrimination.

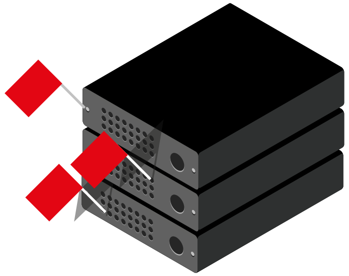
The user friendly, cheap and easily accessible fintech applications have shifted their costs on merchants and have enticed customers to spend more. Online buyers have been subject to assessment of their creditworthiness by fintech's expanded use of private and online data, resulting in inappropriate access to lending and over-indebtedness. Some fintech applications have worsened existing problems, for instance by predatory microfinance and exploitative lenders. They have made it easier to target more vulnerable people, trapping them in debt and exclusion.



2.
Citizens left unprotected against digital crime and fraud

The way fintech applications have been able to develop, has increased the risk and execution of cyber-criminal attacks and new fraudulent extortions through means of online and mobile data and devices, with serious financial losses and negative impacts on people's lives. The speed of growth, the size and global spread of abusive digital financial practices not in the least in the Global South, has made the finance system more vulnerable to fraud and crime.

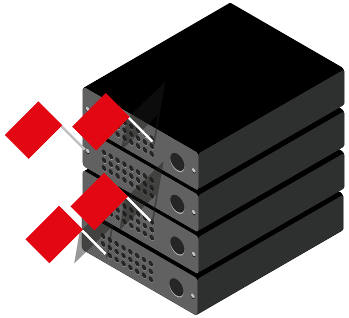
The unregulated status of many fintechs and crypto-currencies have allowed them to avoid regulations and taxes, thus undermining government's authority and resources.



3. Fintech extractivism increases inequality

Fintech is another seemingly endless opportunity to make profits out of mobile and digital financial services or by investing in new or large fintech providers. The fintech sector mimics, in fact supercharges, the extractive features of the traditional finance industry. It generates income in multiple ways, by collecting (high) fees – even from the poorest people – from banking services, gathering and processing all kinds of (financial) data to offer new fintech applications, managing fintech related investment products, and holding shares and betting in fintech providing companies. Popular profitable 'buy-now-pay-later' fintechs have been expanding alongside the more easy-to-use, fraudulent or predatory fintech tools. These fintech applications have increasingly indebted and impoverished especially the young and the poor struggling during the pandemic and in times of rising living costs. Private investors on the other hand, withdraw from fintechs whose profitability is lost, e.g. those serving the poor, as happened in 2022. Due to corporate tax strategies, countries where fintech profits are made are missing tax revenues and opportunities to invest the revenues in their countries.

These trends make it increasingly likely for unequal benefits to be the result of fintech's development.

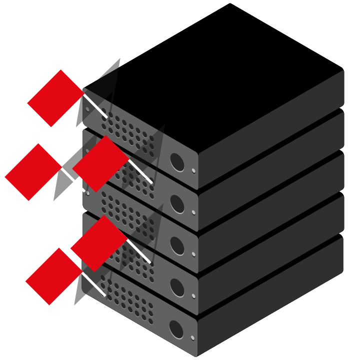


4. Big tech, fintech, and big finance: a toxic mix

Fintech cooperation among big tech, fintech and big finance companies saw new risks arise from their growing connectedness and interdependence. This leads to situations where any disfunction at one player in the fintech chain will affect the others. In 2022, the crypto-world saw how its strong interconnectedness resulted in a serious meltdown, with some people making huge losses.

Harmful impacts result from blurring sectoral and country boundaries, and combining data spanning the whole of a big tech company offering fintech services. Such practices induce even more data gathering and processing with too little privacy guarantees. Increasing complexities and co-dependencies caused by integrating software and technology such as artificial intelligence, blockchain and cloud services, make fintech ever more difficult to manage. It results in a lack of capacity to swiftly detect or remediate the problems, and diffuses the needed accountability.

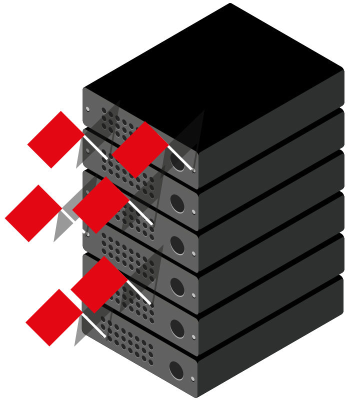
Competition for market share and profits between fully digitalised banks or other financial services providers, and their brick-and-mortar counterparts also encourage questionable practices to the detriment of some customers. As a consequence of these practices and trends, the integrity and the governance of the finance system are at stake.



5. Growing concentration and dependency: becoming too big to fail?

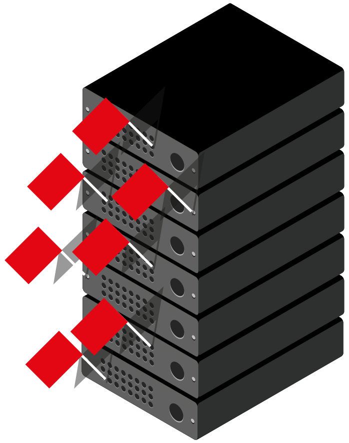
Big techs' combined use of databases, technologies, software and ecosystems to provide fintech services has increased pressures on all players to maintain competitiveness and fostered horizontal as well as vertical consolidation in national and international fintech markets. Fintech or infrastructure providers that gain dominancy may abuse their market power and lock in consumers and merchants through network effects.

The rapid digitalisation of financial services is becoming increasingly dependent on a few state-of-the-art, often foreign, fintech providers, cloud services or other digital payment infrastructures. This trend is barely countered by state-operated digital payment infrastructures. Moreover, large and dominant fintechs have ample resources to protect and defend their interests. By becoming so important, big fintech or digital infrastructure providers, or their financiers, may need to be bailed out with public money in case they face financial turmoil or bankruptcy.



6. Complex challenges ahead

Fintech innovations are far from over. They are evolving through the intensified use of artificial intelligence and machine learning, automation, outsourcing operations in the cloud, open software, blockchain, payments in the Metaverse, and official or commercial digital currencies. Fintech's expansion and safety will be impacted by geopolitical tensions and adverse macro-economic conditions. These future, sometimes self-reinforcing, dynamics will influence the online and digitalised financial services industry, as well as big tech and the financial system. These new trends will add to the already existing challenges and complex problems of the fintech industry.



7. Policy makers, regulators and supervisors: too little too late

Financial policy makers, legislators, regulators, and supervisors are losing the race against swiftly evolving and complex or even criminal fintech developments. Because of their hesitancy to stifle digital innovations, they now lack much needed policies, laws, and mandates to cooperate across borders and across many sectors so as to govern fintech's direction in a holistic way. Important blind spots persist in the regulation of co-dependencies within and among big tech, fintech, crypto- and big finance companies, and their strategies to dominate particular fintech markets. The introduction of much needed legislation might be hampered by well-funded lobbying by the fintech industry and conflicts of interests.

Many central banks are still considering issuing their own digital currencies to raise publicly backed money in the fintech sphere but many issues of trust, operation and usefulness are not yet resolved. The introduction of central bank digital currencies (CBDCs) will increase the pressure on regulators and supervisors who still seriously lack the necessary fintech and crypto expertise. Overall, it leaves fintech developments without a democratic governance to address their societal challenges.

The way forward: prioritising the public interest

It is high time to raise public and political awareness of the actions urgently needed. Fintech-related risks and harmful impacts need to be addressed, while also tackling existing structural and new cross-sectoral issues. So far, rapid fintech developments have not been met with sufficient democratic scrutiny to benefit each country where fintech operates. More attention needs to be paid to how fintech applications and devices are competing with scarce energy and natural resources, and to whether fintech or crypto-assets contribute to the misallocation of financial resources. Valuable alternatives to corporate fintech must be brought to consideration when defining policies and regulations.

Citizens, civil society organisations and independent academia ought to be more involved in decisions about halting harmful applications. They also should be involved in exploring and promoting fintech alternative developments that will serve those who need them most. Key goals of the use of fintech and (crypto?) money should ideally be to accelerate the transition to more sustainable and inclusive societies and economies by financing effective ways to tackle climate change and inequality. Some of the current combined dynamics of big tech, fintech and the finance sector, are thwarting these desired objectives.

Colophon

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