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DIGITAL PLATFORMS: DEVELOPMENTS IN THEIR  
REGULATION AND CHALLENGES IN THE FINANCIAL  
ARENA

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## ABSTRACT

As has happened with other industries, large technology companies are increasingly present in the financial services sector. In addition to being providers of digital tools and solutions, these firms can also act as a distribution channel for goods and services that are traditionally produced by financial institutions. Further, in certain business niches, BigTech firms are also emerging as new, direct competitors to banks. Without prejudice to the potential benefits that this new situation could present, the significant disruptions caused to industries by the increasing consolidation of digital platforms' activity have prompted European institutions to instigate various actions aimed at nurturing the fairest functioning of the markets in which they act. One of the most recent examples is the Regulation on promoting fairness and transparency for business users of online intermediation services, in addition to other competition and general regulatory initiatives for European digital services markets. Despite their broad scope, these measures enable some of the challenges that major digital actors pose to the financial sector to be addressed. However, they do not give a satisfactory response to another series of more specific and equally relevant matters, such as credit procyclicality, adverse selection and interdependencies. For these matters, more specific approaches are needed that help trace parallels between the activity of these platforms and of those that are already regulated, as a first step in the process to adapt the current regulatory and supervisory framework.

**Keywords:** BigTech, unfair terms, competition, data, digital marketplaces, gatekeepers, interdependencies, digital platforms, vertical restrictions, transparency.

**JEL classification:** E44, F49, G21, G38: L13, L22, L41, O33.

## DIGITAL PLATFORMS: DEVELOPMENTS IN THEIR REGULATION AND CHALLENGES IN THE FINANCIAL ARENA

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### Introduction

One of the most salient aspects of the current technological transformation process is the growing consolidation of new industrial organisation models. Their most distinctive feature is the marked prominence of digital platforms (e.g. Google or Amazon). While they do not yet control the factors of production, these platforms significantly influence value creation, given their role as one-stop shops for a broad range of goods and services (López-Ibor (2018); Brunnermeier and Harold (2019)).

This shift in traditional economic and relationship structures (Karimi and Walter (2015); Rauch et al. (2016)) can significantly affect those industries, such as the financial sector, that offer intermediation services (Mattila et al. (2018)), thus forcing incumbent agents to swiftly redefine their competitive strategies. As these sectors are also heavily regulated, this change also presents major challenges for authorities, who must articulate new arrangements so as to preserve their control and supervision capacity (González-Páramo (2017)).

Some organisations are fostering the development of specific regulatory frameworks to help encourage responsible conduct on the part of the market or some of its key actors. Actions of a more proactive nature are also being promoted to prevent disruptions that would be difficult to correct (Crémer et al. (2019)). More specifically, in Europe, the first EU regulation on digital intermediaries' activity has recently been approved.

This article analyses the main features of digital ecosystems and the key elements of the aforementioned Regulation, paying particular attention to the related impact on the financial sector.

### Digital ecosystems: main benefits and challenges

Irrespective of their specific circumstances, all digital platforms share a series of qualities<sup>1</sup> that can change the status quo (see Figure 1). One of their main effects is to boost general economic productivity (Evans and Gawer (2016); Watson (2013)) by helping to reduce search costs, dismantling barriers to entry and contributing to the

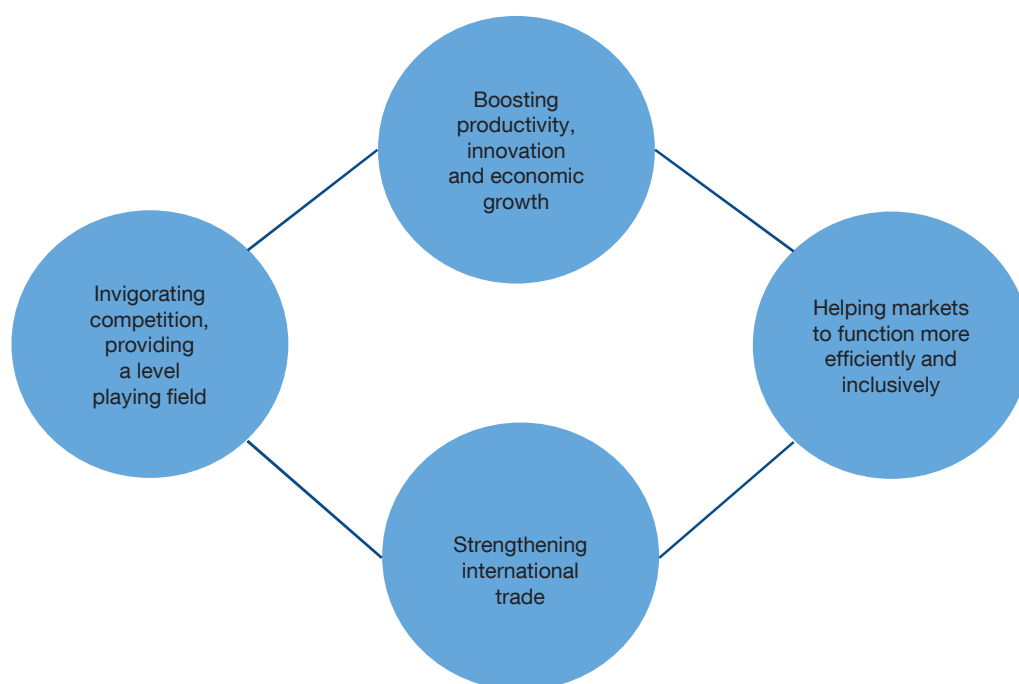
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1 Economies of scale, economies of scope, economies of learning, network effects, etc.

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Figure 1

**POTENTIAL BENEFITS OF DIGITAL PLATFORMS**



SOURCE: OECD (2019).

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emergence of new collaboration models that harness synergies and optimise resources. Moreover, as they correct certain information asymmetries, these ecosystems can be conducive to competition, price reductions (Brynjolfsson and Smith (2000); Ellison and Ellison (2009)) and the broadening/tailoring of offerings (Tanda and Schena (2019)).

Digital platforms are also the providers of the technological infrastructure and tools used by third parties. Given this role, they are key to accelerating internal innovation processes and modernising the business sector. Moreover, as they help to formalise exchanges by giving them greater visibility, they also assist in combating the underground economy (Observatorio ADEI (2018)).

Notwithstanding the foregoing, digital platforms also pose a series of significant challenges to the sound functioning of the markets (see Figure 2). Their ability to quickly scale up may lead to market concentration, prompting a profit-capture effect typical of a natural monopoly. In this regard, authorities are especially concerned by the possible widespread use of unfair commercial practices that harm society (United Nations Conference on Trade and Development (2019)).

In particular, one of the most likely scenarios to emerge is the consolidation of dominant positions in data, as the platforms are the linchpin of our social ecosystem

Figure 2

**POTENTIAL HARM OF DIGITAL PLATFORMS**



SOURCE: Japan Fair Trade Commission (2019).

and can process data at decreasing marginal costs. This generates a differential knowledge<sup>2</sup> and consequent growing market power (Zuboff (2015)), added to which are new barriers to entry, such as restrictions on the access and/or use of such information by third parties. Similarly, the conditions for obtaining and selling these data and the materialisation of conflicts of interest when they are used give rise to as many other points of friction, such as the presentation of biased offerings, price discrimination, invasion of privacy (Mikians et al. (2013)).

## Governing the digital platform economy: the Regulation on promoting fairness and transparency for business users of online intermediation services

The disruptions that can be caused by over-reliance on digital platforms<sup>3</sup> (such as opacity, unilateral trade terms and unfair terms) warrant the proliferation of public action. Within the EU, the Regulation on promoting fairness and transparency for

2 As a result not only of the volume and diversity of data, but also of the fast efficiency gains of the analytical tools processing such data.

3 For example, according to the United States Department of Commerce, at end-2018 Amazon's share in online retail commerce was 40%. One-third of this income came from sales made on the platform by third-party retailers. Similarly, 42% of small and medium-sized enterprises (SMEs) that participated in the 2016 Eurobarometer stated that their business viability depended on online markets.

business users of online intermediation services<sup>4</sup> is particularly important; this recent legislative commitment aims to create a fairer and more transparent online ecosystem.

For practicality reasons, the scope of this Regulation is limited to the most pressing matters. Thus, its provisions are geared to two large groups of actors: a) companies offering online intermediation services to firms (e.g. Amazon, Facebook, Apple App Store) and b) providers of online search engines (e.g. Google, Bing, Opera).

The Regulation is focused on two priorities: first, improving the levels of transparency surrounding these services; and second, implementing effective redress mechanisms to facilitate the resolution of disputes with business users. However, the aspect covered in most depth is transparency (see Table 1), given the marked shortcomings in this area<sup>5</sup> (European Commission (2016)).

As a result, the Regulation prescribes in great detail aspects relating to the drawing up of terms and conditions, including the obligation to make them available to third parties at different stages of the commercial relationship. In addition, any possible changes must be notified to the business users concerned in good time, and the ultimate providers of each good or service must be identified.<sup>6</sup>

Moreover, the Regulation sets out the conditions under which the provision of technological services may be restricted or suspended completely<sup>7</sup> and the duty to inform consumers of whether their primary offering may be accompanied by a complementary offering, and under what circumstances.

Another relevant aspect pertains to the disclosure of the ranking criteria used by digital intermediaries, be it when displaying the results of an online search or the order of offerings listed on a marketplace. This measure is aimed at providing a better understanding of the rationale behind these practices so as to be able to support the effective functioning of the markets, curb potential abuses or biases and allow for influencing such listings in a limited, objective and predictable manner.

The Regulation also requires platforms to disclose any technical or commercial advantages that they may provide to their own offering - including to the

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4 Regulation (EU) 2019/1150 of the European Parliament and of the Council of 20 June 2019 on promoting fairness and transparency for business users of online intermediation services. This Regulation is applicable from 12 July 2020.

5 The European Commission's public consultation in 2016 revealed that transparency and data processing were the two main concerns of economic agents with regard to online platforms.

6 For the resolution of potential disputes, in addition to action before the competent national courts, it also envisages establishing internal complaint-handling systems and identifying mediators to facilitate out-of-court settlements.

7 The research being carried out by competition authorities across the world sheds some light on this type of practice. These include, for example, the discrimination of some of the products in a business user's portfolio on sale via the platform, allegedly in an attempt to prevent conflict with similar products sold either by the platform itself or by other business users.

Table 1

**MAIN TRANSPARENCY REQUIREMENTS IN THE REGULATION**

General terms and conditions of intermediation contracts	Ranking of offerings and search results	Differentiated treatment	Data	Restrictions to offer conditions through other means
Clarity and simplicity	Maintain an up-to-date description of the main parameters, their relative importance and their justifications	Explain when technical or commercial advantages are applied to certain offerings relative to others, setting out the justifying considerations	Identify the conditions under which the platform may access the data provided or generated by business users after termination of the contract	Publish the grounds for imposing limitations on the ability of business users to offer the same goods and services under different conditions through other means
Available in all stages of the relationship	Make known, if applicable, where the parameters include the possibility to influence or alter the ranking order and the effects thereof		Identify the categories of data and under what conditions intermediation platforms and business users may access the data provided by the latter or generated through the use of the platform's services	
Explain the reasons to restrict, suspend or terminate the provision of services	Future practical guidelines from the European Commission		Identify the extent to which a business user may access the data that may have been provided or generated by any business user or consumer in the context of the provision of the platform's services	
Give the business user the opportunity to clarify the facts and circumstances leading to the suspension or termination of the service			Data provided to third parties by the provider of online intermediation services and, where applicable, the purpose of such data sharing	
Specify additional distribution channels and the conditions for marketing ancillary goods and services and their type				
Detail the effects on the ownership and control of intellectual property rights				
Minimum notice period for changes				
Identify the business user providing the goods or services				

**SOURCE:** Devised by authors.

undertakings or corporate websites which they control - compared with that of other business users.<sup>8</sup>

It also addresses the conditions under which both the platforms and business users can access and use the personal and other data generated or provided in the context of the provision of the digital services.

To guarantee proper compliance with all these requirements and speed up the resolution of other issues that could arise in relation to the services provided, the Regulation also envisages establishing internal systems for handling complaints of business users.

Lastly, the Regulation incorporates two notable developments: establishing an Observatory on the Online Platform Economy and encouraging the drawing up of codes of conduct. The Observatory will enable developments in the ecosystem to be monitored with a view to designing more effective public policies. Codes of conduct will strengthen digital agents' commitment to public policy objectives, addressing detailed aspects for which a law is too rigid an instrument due to this industry's dynamism.

Beyond this Regulation, concerns over the potential anti-competitive effects<sup>9</sup> of digital intermediaries have given rise to another area of debate. Specifically, they have prompted a reassessment of the sufficiency of the market economy's existing system of protection, which could see further tightening. Attention appears to be focusing on three areas, inter alia.

First, there are calls to reverse the burden of proof and, where there is suspicion of anti-competitive conduct, to put the onus on the platforms to demonstrate that their actions neither impede nor block the activities of rival companies (Bundesministerium für Wirtschaft und Energie (2019)).

Second, it is suggested that merger operations be assessed based on broad criteria taking into account the potential strategic importance of the acquired company for the market in the future (Digital Competition Expert Panel (2018)).<sup>10</sup> In short, the intention would be to anticipate the extent to which the acquisition or integration of an emerging company could result in the removal of a competitor or strengthen the platform's dominant position (Competition and Markets Authority (2019); Australian Competition and Consumer Commission (2019)).<sup>11</sup>

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8 Similarly, the existence of potential restrictions to the freedom of the ultimate providers of goods and services to market them through other channels under more favourable conditions must be explained.

9 Aside from the anti-competitive aspect, there are various public initiatives relating to privacy and taxation that are beyond the scope of this article.

10 For example, factoring in the nature and strategic importance, in broad terms, of the assets sought to be acquired (data, technology, etc.).

11 Under consideration is, inter alia, a requirement that such transactions be notified earlier and that all transactions that may have an impact on the domestic market, even those carried out abroad, be included.



Third, consideration is being given to the circumstances in which access to the data held by the platforms may be indispensable to guaranteeing healthy competition. In such cases, a clear framework of obligations may be required to facilitate an open and routine exchange of data which helps overcome the current limitations of the Revised Payment Services Directive (PSD2) in terms of its scope.<sup>12</sup>

The European Commission echoes all of the above in a new initiative to modernise the legal framework currently applicable to digital services. These actions aspire, inter alia, to ensure a level playing field in the functioning of European digital markets so as to strengthen their competitiveness and offer consumers greater choice.<sup>13</sup>

## The potential impact of these measures on the financial system

The above-mentioned measures are admittedly not geared to resolving the problems specific to the financial services industry. However, the sector is not immune to the issues they seek to redress: asymmetries in bargaining power, restrictions on access to data, conflicts of interest, etc. (Martens (2016)). Nor is it insulated from the general challenges stemming from digital transformation (such as privacy) and that frame this initiative. However, the lack of any practical experience with these measures makes their effectiveness difficult to assess for the time being. Despite these limitations, certain inferences can be drawn.

For example, from the standpoint of financial stability, the existence of these new agents gives rise to four major challenges (Financial Stability Board (2019b); Bank for International Settlements (2019)): a) increased general business risk for traditional financial institutions, compromising their solvency and encouraging shadow banking; b) the emergence of new - or the extension of existing - types of interdependencies that may be opaque to the regulator/supervisor; c) the concentration of the offering in the medium term; and d) more erratic and unstable credit behaviour.

Although the above challenges are beyond its scope, the Regulation still provides a useful framework for pressing towards a solution. First, improved transparency from platforms<sup>14</sup> - also fostered by the Observatory - should help to identify and respond to potential pockets of disruption, reducing the scale of the risks and highlighting

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12 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.

13 As stipulated by the EC in its consultation of 2 June 2020 on the regulatory framework for digital services, an ambitious examination is under way that could, among other aspects, conclude with the adoption of specific rules for a particular type of actor, such as platforms of a certain scale and those that act as gatekeepers. The options under consideration include concrete measures to address self-preferencing and the introduction of non-personal data access obligations, specific requirements regarding personal data portability, or interoperability requirements.

14 Both in the conditions applied to the provision of technology services and in how they leverage their position as gatekeepers.

regulatory shortcomings. Second, correcting certain biases or discriminatory practices in the provision of services to business users should foster healthier competition and temper the pace and scale of the aforementioned repercussions.

However, the Regulation abstains from addressing other matters of particular importance for the financial sector, such as those stemming from unilaterality in negotiations, vertical restrictions, unfair terms and the widespread use of other improper commercial practices. Likewise, neither the Regulation nor the complementary approaches described in the above section tackle the problems specific to the financial industry, such as those inherent in credit procyclicality, adverse selection or the systemic consequences derived from unawareness of the nature of interdependencies. These issues require a specific approach that identifies the particular aspects of the digital platforms' business that, based on their nature and risks, are comparable to regulated activities and those that, owing to their implications for the latter, may require specific ancillary rules (European Commission (2019); European Banking Authority (2018)).

The Regulation is far less ambitious with regard to data. Although it helps to clarify how the information supplied and/or generated in the context of the platforms' services will be processed, it does not address the most pressing matter: providing financial institutions with a compulsory, objective, fair and practical system for accessing data similar to that under PSD2. In its absence, there is nothing to prevent the managers of those platforms from strategically leveraging their data advantage, even to the detriment of social well-being (Graef et al. (2014)) or - what amounts to the same - to that of financial stability, whether by eroding the solvency of traditional institutions<sup>15</sup> (Financial Stability Board (2019a)) or by preventing these from harnessing such data to accurately assess the risks to which they are exposed.<sup>16</sup>

To contend with this scenario, the growing role played by competition authorities both in Europe and in the United States<sup>17</sup> is expected to be a decisive (but not exclusive) factor. Their limitations in terms of speed and flexibility suggest the need to employ other, more ambitious approaches (Lambrecht and Tucker (2015); Lewis and Rao (2015)),<sup>18</sup> such as those included in the European Commission's recent raft of measures for the digital sector, and other action that may be taken in future by international standardisation bodies.

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15 The Financial Stability Board points, *inter alia*, to a sharp reduction in margins or a loss of market share for financial institutions on account of BigTech firms' entry into the realm of financial services. It also anticipates that institutions may loosen lending standards, increasing their exposure to credit default risk.

16 For an illustrative example of how non-traditional data can be used to better predict credit default risk, see Gambacorta et al. (2019).

17 One example is the joint appearance in July 2020 of the CEOs of the world's four biggest tech firms before the US House Committee on the Judiciary, as part of an investigation into alleged anti-competitive behaviour.

18 For example, European competition authorities have to date found no signs of the formation of data oligopolies, owing to the difficulty of being able to clearly prove that data are indispensable.

## Conclusions

The growing emergence of digital platforms portends important changes to how economies are organised and how they function. This may give rise to considerable benefits, but it simultaneously poses new (and, in the case of financial services, especially significant) challenges for economic authorities.

Accordingly, numerous public authorities have begun paying close attention to the phenomenon, prompting an international debate that has been particularly intense in Europe. The ultimate aim is to define a balanced and reliable governance framework for this activity such that all of its advantages can be harnessed with minimal drawbacks.

A first step in this direction was the recent adoption of the Regulation promoting fairness and transparency for business users of online intermediation services. This Regulation aims to foster a more balanced relationship between the providers of platform services and the companies using such infrastructure for business purposes. To that end, the Regulation focuses on meeting two priority objectives.

First, it introduces measures to strengthen transparency regarding the conditions under which these services are provided, including relevant data processing aspects. Second, it drives the implementation of effective redress mechanisms to facilitate and speed up the resolution of potential disputes initiated by business users. Additionally, the Regulation envisages establishing an Observatory to allow for a more exhaustive assessment of the practices of such operators and potentially instigate further public policy measures. In tandem, public authorities are implementing another series of initiatives more directly related to protecting free competition.

In terms of the implications for the financial sector, the consolidation of digital platforms poses specific challenges that this Regulation can only partially address. As a result, issues of the utmost importance are yet to be resolved. Some of these are general (e.g. unilaterality in negotiations), while others are more specific and pressing, such as their impact on credit procyclicality, adverse selection and in terms of the systemic consequences of greater interdependencies.

Dealing with these issues requires a detailed examination of each of the activities performed by the platforms, thus determining whether they are comparable to areas already regulated by financial authorities or, conversely, if they warrant the development of specific ancillary rules owing to their spillovers on such areas.

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