

KALIFA REVIEW

Finance Innovation Lab’s response

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1 Overview

The [Finance Innovation Lab](#) welcomes the attention and focus on the future of fintech. Last December, we published our [report](#) *Lifting the Lid on Fintech*, which examined the acceleration of technology-driven innovation in finance and explored how fintech is transforming finance on a systemic level, leading to worrying concentrations of power and increased threats to democracy, sustainability, justice, and resilience in finance.

It is our position that the Kalifa Review is inadequate and that in order for fintech to truly transform financial services the government should prioritise maximising the social purpose and sustainability of the sector. We are also concerned that the Kalifa Review failed to include an impact analysis addressing the unintended consequences of greater technology and innovation in financial services, as well as an assessment of the existing regulatory framework's ability to protect consumers against this.

This briefing note provides an overview of our response to the Kalifa Review and five asks of the government to take into account when responding to the review and implementing recommendations:

1. **Involve** civil society and consumer groups
2. **Prioritise** financial and digital inclusion
3. **Protect** people's data
4. **Promote** a diversity of business models
5. **Support** the existing physical infrastructure

We would be happy to discuss this in more detail. Please contact David Fagleman, Advocacy Associate davidf@financeinnovationlab.org.

2 Response

We agree that a strategic approach is necessary. However, the review prioritises growth and competitiveness over social purpose and sustainability, which we believe is misplaced. Unless social purpose and sustainability are the priorities for fintech, there is a major risk that the financial system of the future will entrench inequality, exclusion, and the climate and environmental crises. Investment, jobs and an economic recovery are crucial but the review missed a golden opportunity to map a new path that transforms fintech to promote democracy, sustainability, justice and resilience. We therefore believe that as it stands, the Kalifa Review is inadequate.

The review makes the assumption that fintech will deliver benefits in financial services in terms of enhanced choice and competition, access, and inclusion. Yet, there is no meaningful analysis to support these claims. It is our view that more competition does not necessarily equate to better choice or improved service, and there is a danger that the combination of fintech and big data could result in greater, not less, exclusion and discrimination.

The review lacks an impact analysis into the unintended consequences of greater technology and innovation in financial services. Not everyone is capable or comfortable using digital technology and they risk being excluded or marginalised by fintech. There is no meaningful analysis in the review to address the systemic risks that fintech is driving, arising from the dependence on a handful of Big Tech firms for critical infrastructure, instability in the stock market caused by AI's predictive model and the growing risk of cyber threats. In addition, while there are new players in finance, small groups of big firms continue to dominate the sector (e.g. just two firms, Visa and Mastercard, control 98% of the UK card payments).

The review does not adequately explore the sustainability of fintech. While going digital presents opportunities to reduce the environmental impact of financial operations, the values currently underpinning fintech risk working against our social and sustainability goals. We believe that if the government decided that a proportion of the UK's private pension schemes should support fintech growth, as advocated in the review, this should exclusively invest in sustainable and socially responsible fintech. The review highlights job creation and growth but researchers at the University of Cambridge estimate that AI will lead to the creation of just 10% of the jobs it will destroy in the finance sector over the next decade. Global computing and internet-connected devices now account for about five per cent of the world's electricity production – and this could rise to 20% by 2025.

The review acknowledges that steps should be taken to improve financial inclusion and moderate the impact and risks of AI decision-making. However, we are concerned that the recommendations proposed do not go far enough and that these areas will be overshadowed by the marquee recommendations and not adopted by the government.

We welcome the recommendation that any implementation of open finance should have financial inclusion at its heart. In order for this to be meaningful, the government should have a clear understanding of the benefits open finance could deliver for people currently marginalised by the financial system, and a strategy to support the use cases that will bring about those benefits.

The review does not address the need for the regulatory framework to be enhanced to ensure that regulators are able to match the pace of innovation, particularly when it comes to products and services developed around AI and big data. Regulatory supervision must be able to adequately manage firms and ensure they are responsible for the outcomes of their operations.

The review notes that the “requirement for all data to be “necessary” for the purpose for which it is collected makes it difficult for firms to experiment with personal data sets, including using AI, where the outcome of that experiment may be unclear when the data is collected.” This is a concern as personal data must be protected to the fullest extent. Further, we are apprehensive about a universal approach to digital ID. While we agree with the principle, great care must be taken to ensure that this balances privacy and anonymity and avoids controlling and exploiting citizens.

The review represents the interests of industry and should have gone much further to enable members of the public and civil society to have a say in the future of fintech, which would make the sector more effective, transparent and accountable.

3 Asks

1. **Involve** civil society and consumer groups

In developing a comprehensive fintech strategy, **we ask that the government involve civil society representatives and consumer group representatives.** Without such representation, there is a risk that the proposed bodies, such as the Digital Economy Taskforce, SME Finance and Open Finance coalitions, will end up being dominated by industry voices which have the greatest resources and do not have the relevant expertise. These positions should play a formal role in any decision-making structure and be appropriately remunerated.

Policy and regulation around fintech should mandate for processes to be as transparent and accountable as possible. Designing and developing use cases for end consumers and data users should be done in an open and consultative way that maximises engagement and input from different stakeholder groups, including vulnerable customers, and stakeholders both in different sectors and across multiple sectors.

2. **Prioritise** financial and digital inclusion

We ask that the government prioritise addressing financial and digital inclusion in their response to the review. The review included recommendations to improve financial inclusion, however they did not feature as marquee recommendations and there is a risk they could be overtaken by higher profile issues.

Fintech will only create meaningful change, and truly transform financial services, if everyone can benefit from it. This means that as a first port of call, the government should take this opportunity to address the digital capability gap that excludes millions of people, particularly the vulnerable, from accessing financial products and services predicted in the review. Initiatives such as a universal approach to digital ID will fail to benefit society as a whole if some are not able to benefit from it. According to the Lloyds Consumer Digital Index, an estimated 12 million (22%) people in the UK are without the skills needed for everyday life.

It is our view that any measures to involve fintech in addressing financial inclusion must involve civil society and consumer groups to ensure that the development of new products and services reach those in need and deliver long-term solutions.

3. **Protect** people's data

Discussions around the future relationship between financial services and data can at times assume that the availability of, and access to, data will always lead to good

outcomes. This is not always the case and can potentially expose vulnerabilities, potentially leading to more exclusion for the most vulnerable. Great care must be taken on this area as digital records can be made without user awareness and they are difficult to amend. Our research shows that seven-in-ten (69%) of the UK population do not feel comfortable sharing more data about their daily life and activity in order to easily access financial services.

We need a public debate that asks what people's data can be used for, for example, why should data shared to access finance be used to develop products to enhance targeted advertising? **We ask that the government employs a 'protect people first' approach when it comes to data and financial services and ensures that the regulatory framework is adequate to manage AI and big data financial products.**

4. **Promote** a diversity of business models

A healthy market is a diverse market that can provide the range of products and services necessary to cater for every citizen. Co-operative, mutual and community run fintechs can offer financial support that big tech may miss and see as risky or insignificant, as well as offering an added layer of resilience in the financial system.

We ask that in response to the Kalifa Review the government provides support and incentives for purpose-driven fintech led by organisations that embed social and environmental purpose in their mission, culture, business models, and governance and ownership structures.

5. **Support** the existing physical infrastructure

Recent research has shown that 11.6 million people in the UK used cash more than once a week for day-to-day transactions in 2020, with over 2.5 million using it everyday. The fast pace of digital adoption is contributing to the demise of physical service provision such as bank branches and cash. One of the reasons people value cash is that it is easy to control spending to keep within a budget, and this may become especially important in the coming years as households recover from the impact of the pandemic.

We therefore ask the government to commit to support and maintain the existing physical infrastructure to ensure that people can access cash for free and continue to access a physical bank branch locally.

4 Analysis of fintech

The below information is from the Finance Innovation Lab report, *Lifting the Lid on Fintech*. It can be accessed [here](#) and we would be happy to provide you with face-to-face briefing.

4.1 Fintech and Data

Fintech means much more than increasing the convenience of existing financial services using technology. Core financial services – banking and payments, lending, savings and investment, insurance – remain available, but technology creates new opportunities for data gathering that potentially fundamentally changes the business models underpinning them.

The digitisation of society has also made new kinds of data available. Financial services firms increasingly combine traditional financial data with ‘alternative data’ including social media activity, browsing history, and data captured on mobile phones (such as photos and calendar entries). All of this – and more – can be used to determine what services you can access, and for how much. For example, Lenddo pioneered credit scoring based on a person’s social network. Tala uses data from people’s phones – such as how often you call your mother – to determine lending decisions. British credit-scoring firm Big Data Scoring monitors the way you complete a form.

A range of organisations – often acting behind the scenes across finance and other sectors – provide data and IT services. ‘Data brokers’ such as Acxiom and Experian (which is also a major credit reference agency) specialise in collating and selling private and public information about individuals. This can include driving records, media reports, changes of address, social media content, and purchases. Payments companies enable and oversee the growing number of digital payments. Giants like Visa, Mastercard and PayPal are all now valued more highly on the stock market than the UK’s biggest bank, HSBC.

The ability of companies to claim property rights over data has led to the emergence of a new type of enterprise known as ‘the platform’. According to the think tank IPPR

“A platform is a business that acts as an intermediary between users, extracting value from their activities on the basis of the data generated. This value can be monetised by various means: through selling advertising, targeted using data and analytics; through charging an access fee for a service; and, sometimes, through charging for exclusive use of hardware.”

The platform has become the dominant data-driven business model of our economy. Today, leading platforms – Big Tech – are the most profitable companies in history. The combined market valuation of Apple, Amazon, Google and Facebook rose to over \$5 trillion for the first time in the second quarter of 2020, equivalent to nearly one fifth of the value of the entire S&P 500.

- The combined annual revenue for the world’s five largest companies [Apple, Microsoft, Amazon, Alphabet, Facebook] by market value – all of them platforms in some form – already exceeds the GDP of 90% of the world’s countries. — Lawrence and Laybourn-Langton 2018
- Google accounts for 87% of the UK search engine market. The share of its nearest rival site was 6%. — Statista 2020

Platforms tend towards monopoly because of ‘network effects’. This means that a platform’s usefulness increases in proportion to the number of users it has. For example, you use WhatsApp/Facebook because your friends, family and clients do. You use Uber because it’s most likely to connect you with a range of taxi drivers working nearby. Platforms also benefit from significant ‘economies of scale’ which are accentuated by the unusual nature of data. The profitability of Big Tech firms now depends on ‘surveillance capitalism’ – harvesting information to create products that predict and influence our future behaviour.

4.2 Fintech and Big Tech

The relationship between fintech and Big Tech is three-fold:

1. Big Tech is becoming a financial services provider
2. Fintechs, banks and other financial services firms are developing platform businesses
3. Big Tech owns and controls the infrastructure on which finance relies

Big Tech’s expansion into finance can be understood as a way to maintain user attention within a platform. In this way, surveillance of behaviours can continue – for example where a user does not need to leave the platform to organise a bank transfer – also providing a wholly new source of valuable financial data.

Fintechs, banks, and other financial service providers have been learning from, and experimenting with, the platform business model. They are now able to draw on well-established ecosystems of investment and support that have developed over the past two decades.

The platform business model is most conspicuous in fintechs that manage payments, crowdfunding, and peer to peer (P2P) lending. These sit between multiple parties and generate network effects. Drawn by the promise of future growth and monopolistic returns, platforms are able to attract investment (including from venture capitalists), even when they are not yet making money or face losses. The fintech industry

accounts for the greatest share of ‘unicorns’ – privately held start-up firms valued at over \$1 billion – globally.

Banks are also developing platforms. For instance, BBVA and Goldman Sachs have created software that allows clients to embed its banking services into their own products. This ‘banking-as-a-service’ approach offers businesses the ability to issue digital wallets and manage payments at low cost, while the bank benefits from reaching many more customers via its clients that use the platform.

‘Embedded finance’ describes the integration of finance with non-financial services, and is supported by banking-as-a-service offerings. Examples include Google Maps enabling users to find and pay for parking directly through its app, and stores like Amazon providing options that convert the cost of a product into an automatic loan. This market is anticipated to grow enormously over the next decade, with predicted revenues as high as \$7 trillion. The financial system increasingly relies on Big Tech’s telecommunication and digital infrastructure including web hosting, data analytics, the cloud, app stores, ID services, search engines, and code.

4.3 Risks of Fintech

Fintech is undemocratic

- Fintech firms enjoy unprecedented power as they combine market-wide insights and powerful computing to tailor prices, target adverts, and even influence our behaviour. While individuals have very limited agency regarding the data that firms collect.
- In October 2020 the Information Commissioner’s Office (ICO) – the UK’s data regulator – reported on the findings of a two-year investigation into the three big credit reference agencies, Equifax, Experian, and Transunion. Unknown to most people, all three had also been operating as data brokers for direct marketing purposes. The ICO found “widespread and systemic data protection failings across the sector” that will have affected millions of people.
- Research by the responsible technology charity Doteveryone in 2020 found that awareness of Big Tech business models is increasing, but that understanding remains quite shallow. For instance, four in five members of the public are aware that organisations collect user information (compared to two in three in 2018), but less than half realise that this means they receive different search results to other people.
- Because of the nature of data and the new data-rich business model (‘surveillance capitalism’) developed to profit from it, the lack of balance in knowledge and power between financial service providers and the public is unprecedented.
- Our research shows that seven-in-ten (69%) of the UK population do not feel comfortable sharing more data about their daily life and activity in order to easily access financial services.

Fintech has the potential to be unjust

- Automated decision-making can entrench existing forms of discrimination. Human biases inform the development of new technologies and the historic data sets that train machine learning. These biases are then reproduced through automation.
- Academic research has demonstrated how using machine learning models to allocate mortgages predicts higher probabilities of default for black and Hispanic borrowers compared to more traditional models, despite no information about the race of borrowers being shared with the model. Challenging discrimination is particularly difficult for those most likely to face injustice.
- Financial firms have long used information about our past and about people they consider similar, to make decisions that shape our lives. For instance, they make binary decisions about people’s access to finance based on credit scores. These scores are compiled using certain data sets and analytical methods that are chosen by industry players. This is problematic because selective data analysis often fails to take potentially mitigating individual circumstances into account. It risks marginalising people who do not ‘fit’ a particular profile. New data and technology won’t necessarily resolve this issue – it could exacerbate marginalisation through the inbuilt biases discussed elsewhere in this report.
- Credit scores can reduce our autonomy in accessing financial services, but fintech threatens our autonomy in other ways as well. People will manage their behaviour if they know it is being monitored to assess their suitability for a loan. As more of our online behaviour – from social interaction to the activity recorded by wearable devices – is analysed as credit data, these disciplinary effects will increase. Worryingly, these scores are increasingly used beyond finance. Credit scores affect your ability to rent a home, source a COVID-19 test, and even access the NHS.

Fintech is unsustainable

- Fintech relies upon a very resource-intensive infrastructure. Smartphone manufacture, web searches and emails, and data storage require large amounts of raw materials and energy. Global computing and internet-connected devices now account for about five per cent of the world’s electricity production – and this could rise to 20% by 2025.
- In 2019 Bitcoin – the leading cryptocurrency – required the energy of seven nuclear power plants to process just a small percentage of global payments.
- Data and algorithms are not neutral: they are designed with a specific purpose and encode a set of values and preferences. If human financiers prioritise profit over social and environmental outcomes then the AI that aims to replace their decisions could exaggerate these values. For instance, AI-powered

investment trained to maximise profits could automate capital to shift into fossil fuels, working directly against our climate change targets.