Motivation

- Paper is motivated by empirical evidence on fintech disruption (e.g., Buchak et al. (2018), Fuster et al. (2019), Gopal and Schnabl (2022))
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- Many practitioners expect Open Banking (OB) to change the competitive landscape of the financial services industry

- Open banking: Regulatory initiatives that allow third parties access to customer transaction accounts (upon customer approval)
Paper in a Nutshell

- Paper narrative focuses on a perverse outcome: All borrower types can be worse off as a result of open banking.
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- This perverse outcome is illustrated within a parsimonious framework. Most results can be understood as a skillful combination of 1) Milgrom (1981) and 2) Hauswald and Marquez (2003)
  1) Milgrom (1981) implies that voluntary information sharing (open banking) is effectively not “voluntary” because of adverse inference
  2) Hauswald and Marquez (2003) study the effects of changes in lenders’ screening technologies on credit market equilibria
Model Framework: Adaptation of Hauswald and Marquez

- Two borrower types:
  - high-types always repay
  - low-types always default, but get private benefit (and ask for a loan)
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  - good signal is inconclusive (some bad borrowers get it too)
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- **Asymmetric lenders**
  - strong lender (Pre OB: Bank, Post OB: Fintech)
  - weak lender (Pre OB: Fintech, Post OB: Bank)
Model Overview

Independent Screening Tests: $j \in \{b, f\}$

Signals

$S_j = H$

$S_j = L$

Borrowers

Lenders

Before open banking: $x_f < x_b$

After open banking, on a borrower who signs up: $x'_f > x_b$
(Standard) Equilibrium Properties

- Equilibrium properties (with two active lenders):
  1) Market power: Weak lender makes zero profits. Strong lender makes profit, increasing in screening gap $\Delta$. (Bertrand if $\Delta = 0$)
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3) Mixed strategy: interest rate offers are randomized with strong lender charging higher interest rate (FOSD)

Intuition:

- Suppose weak lender had same strategy as strong lender, then would systematically lose out (winner's curse)
- If weak lender does not make an offer, the strong lender sometimes faces no competition (⇒ optimally charges higher interest rate)
- Makes it possible for the weak lender to sometimes undercut the strong lender (and still make a profit) just enough to offset the winner's curse loss when facing a low-type borrower
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(Standard) equilibrium properties: Comparative statics

- Paper not really meant to analyze allocative lending efficiency (high-type will always get a loan), analysis focuses on borrower surplus

1) An increase in the gap $\Delta$ hurts both borrowers (worse winner curse)
2) Better weak lender’s screening technology (holding $\Delta$ constant) ★

- Increases high-type borrower surplus $V_h$
- Decreases low-type borrower surplus $V_l$

All results of the model can be understood by the interplay of the (1) strategic and 2) information effect
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Marcus Opp

NBER 2022 Open banking

July 12, 2022
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  - generic increases in precision of screening technology of fintech

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This generality is both a blessing and a curse: Is there more to OB than improvement of the weak lender?

Hauswald and Marquez (2003) analyze similar comparative statics to determine effect of IT

- Strong lender's technology improves
  - less competition
  - \( \Delta \uparrow \)

- Weak lender's technology improves
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- Based on the paper’s comprehensive analysis, my reading is that the perverse effect is not the most plausible outcome.

- The paper mentions relevant cases where the perverse effect is absent:
  - **fintech does not compete before OB, enters post OB**
  - **Multiple strong fintechs (post OB)**
  - \[ \Delta \approx 0 \] (almost Bertrand)

- Outside of model: What if fintechs simply have lower costs, so they can be competitive with worse information?

- My preference: Highlight robust mechanism (information & strategic effect) rather than selecting non-obvious results.
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Kitchen-sink out-of-the-model comments

- Model dynamics and additional effects:
  - Fintech: One can only train models with transaction data only after attracting a large number of consumers to share data (implications to generate scale as a precondition for future competitiveness)

- Incumbent: Data sharing affects ex-ante incentives to invest in different data sources
  - Changing the competitive landscape (rather than comparative statics)

- Pre OB: Sequential search with high costs (stop if low enough offer)

- After OB: costless simultaneous offers from “every” lender via app

- Thought on regulator:
  - If banks still benefit from public safety nets and OB implies that banks face more competition on “good borrowers” but not for risky “bad borrowers” ⇒ Increased risk-taking incentives
  - Banks should be more regulated (see Harris, Opp, Opp, 2030)
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Conclusion

- Well-written paper on an important topic
- Paper highlights relevant trade-offs, maybe adjust overall message
- Integrate novel, specific features of Open Banking (because literature on credit market competition is “crowded”)