Fintech in a Changing World

The Sixth Annual Fintech Conference
Federal Reserve Bank of Philadelphia
Philadelphia, PA (virtual/in-person hybrid)

August 3, 2022

Patrick T. Harker

President and Chief Executive Officer
Federal Reserve Bank of Philadelphia

Fintech in a Changing World

The Sixth Annual Fintech Conference
Federal Reserve Bank of Philadelphia
Philadelphia, PA (virtual/in-person hybrid)

August 3, 2022

Patrick T. Harker
President and Chief Executive Officer
Federal Reserve Bank of Philadelphia

Good morning! I'd like to begin by giving a big welcome to everyone here in Philadelphia and to those of you joining us virtually. One of the benefits of hosting a hybrid conference like this is that we derive the advantages of being together physically — I've had some of my best ideas on the sidelines of conferences like these — while also being able to welcome many people who couldn't make it to Philadelphia.

It's great that we have such a huge turnout today. I think that's a testament not only to the growing interest in the subject we are here to discuss — fintech — but also to the stellar lineup that we've assembled for this, the Philadelphia Fed's Sixth Annual Fintech Conference. My colleague Julapa Jagtiani, the organizer of these proceedings, has truly done it again. If you've never been to one of our fintech conferences before, trust me, you're in for a treat. Over the next two days, we will hear from the leading voices in industry, government, and the Fed.

And speaking of the Fed, here is where I give my standard Fed disclaimer: The views I express today are my own and do not necessarily reflect those of anyone else on the Federal Open Market Committee (FOMC) or in the Federal Reserve System.

Our last fintech conference was in November 2021, and although that wasn't even a year ago, I think it's safe to say that conditions for the fintech industry — not to speak of the broader economy — have changed dramatically.

I'll give one example. Last November, I spoke about the rapid growth of *buy now, pay later* firms, which effectively repurposed Kmart's old layaway model for the digital age. With buy now, pay later, shoppers are able to divide payments for purchases into a series of installments — sometimes with zero interest tacked on. And unlike with layaway, consumers benefit from getting the product up front and paying for it over time. This has proved a popular option, with buy now, pay later representing $2 of every $100 spent on e-commerce in 2021.

Buy now, pay later looked robust in a low-interest rate environment. That's because the vast majority of firms in the space have no deposits to tap. Instead, they borrow money that they then turn around and lend. Typically, their revenue comes from fees charged to merchants.

Rising rates have drastically changed the landscape for buy now, pay later. Forced to borrow at higher rates, these firms are facing pressures they simply weren't last November. Unsurprisingly, major operators in the space have retrenched, with one of the leading lenders shedding 10 percent of its workforce last month.

The fintech landscape is changing rapidly as a result of macroeconomic conditions. Significant developments are occurring, and we're lucky to have so many superb panelists here this week to discuss them.

The adoption of buy now, pay later has important implications for offering financial services to low- and moderate-income consumers or others who may be locked out of more traditional means of obtaining credit. Consider a young adult in her first job who has no established credit history and therefore can't get approved for a bank credit card. She can now use buy now, pay later to finance that important purchase. Moreover, some buy now, pay later lenders report payment histories to credit bureaus, allowing these new borrowers to begin to build a credit history.

Or think about the family that declared bankruptcy several years ago and that continues to be charged high rates on traditional forms of lending, even though they're back on their financial feet. Buy now, pay later offers an alternate method of accessing credit.

A survey from the Philadelphia Fed of buy now, pay later users in the United States found that users are generally non-White, lower earning, and younger than users of other payment methods like debit and credit cards.

Fintech, in other words, can help foster financial inclusion. That's undeniable. But that is *far* from inevitable.

Like all tools, fintech can be used for good, ill, or somewhere in between. Just as fintech can foster frictionless legitimate transactions, for instance, it can foster frictionless *fraudulent* transactions as well. Fraud is an example of where a little bit of friction can be a good thing.

Fintech has developed a lot over the six years we've been hosting these conferences, and the discussions like those we will have over the next two days have moved out of the largely theoretical and evermore into the realm of the empirical. We have increasingly rich data sets here in the United States and abroad that provide important insights on how fintech is reshaping credit markets.

Take one example: A recent paper examined how fintech lending differed from traditional bank lending in China during the beginning of the COVID-19 crisis. Analyzing the dispersal of unsecured personal loans by three large fintech firms and a large commercial bank, the researchers found that fintechs were more likely than banks to extend credit to new and financially constrained borrowers. Fintech borrowers were more likely to be unemployed, to earn lower incomes, and to have had prior delinquencies.

A happy story, right? Well, not quite.

That's because it turns out that the delinquency rate of fintech loans tripled after the COVID-19 outbreak, whereas there was no significant change in the delinquency rate for bank loans over the same period. This is a puzzling finding, somehow suggesting that, in this case at least, fintech lenders were unable to accurately predict borrowers' financial health in the event of a pandemic, but commercial banks were. That strongly implies that the Chinese fintech firms were operating with imperfect or insufficient information about their borrowers. While issuing credit to the financially constrained is potentially beneficial, it does no good to the lenders or the borrowers if the loans end up delinquent.

But this is hardly an iron law: Other examples have found fintech loans going delinquent at lower rates than bank loans. That suggests that elevated or lower credit risk is not necessarily inherent to fintech itself, but rather dependent on each firm's particular business model.

Another recent paper that examines unsecured small business loans in India offers an important example. There, the authors found, when fintechs used a more holistic method for evaluating borrowers' credit risk than a simple credit score, both borrowers and lenders benefited.

Over several years, small businesses in India seeking credit from fintechs agreed to share data on their so-called cashless payments, certified checks, Internet banking, mobile banking, point-of-sale transactions, and money transfers on mobile apps. The upshot? They gained access to larger loans at lower rates than those who used traditional credit scores to access credit.

One can imagine such a model working here in the U.S., where the credit constrained are able to demonstrate their creditworthiness in ways besides their credit scores. In my opinion, there is no good reason that on-time rent and utility payments should not be just as determinative in obtaining credit as on-time payments for car loans or credit cards.

Again, the opportunities to use fintech to reach the economically constrained and financially marginalized are truly exciting — and very important. It's now on all of us to seize them.

So again, thank you so much for joining us. We have a very rich menu of programming over the next two days, which I'm sure we will all benefit from.

I'll now turn things over to David Mills, my colleague from the Board of Governors, who will lead a discussion on the future of payments.