Getting the most out of Fintech in Estonia

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Pioneers of the Estonian Fintech need a fair level playing field. Estonia, at the forefront of alternative finance should seize the moment to set framework conditions right.

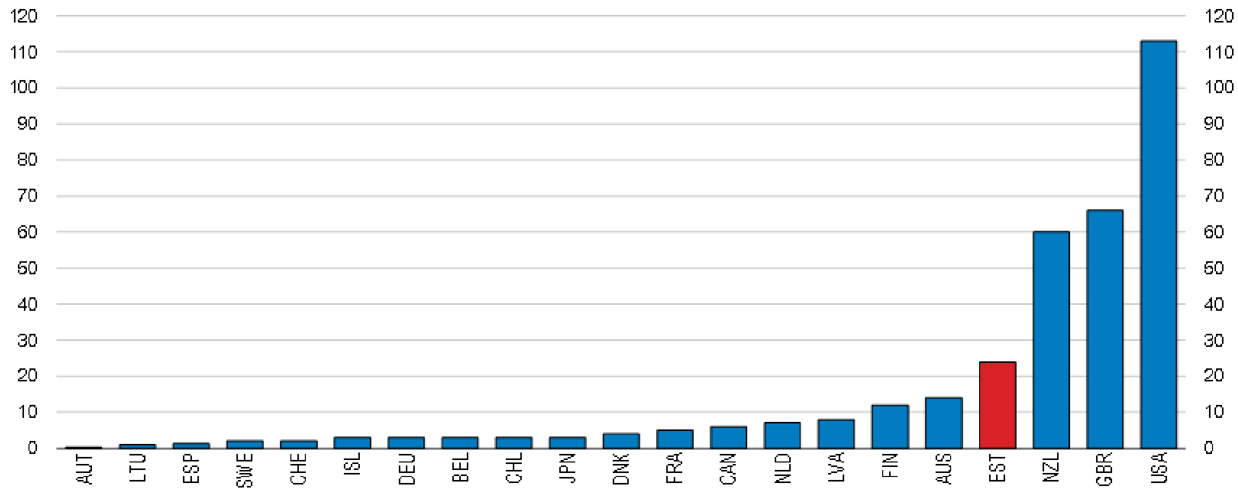
Estonia is a frontrunner in alternative finance and a host to some of the most innovative Fintech start-ups in the OECD – i.e. start-ups using technology and technology-facilitated new business models in the provision of financial services. Some Fintech companies based or born in Estonia have a world-wide reach. These include one of the largest European peer-to-peer lending platforms for unsecured consumer loans, the first worldwide secondary market for venture capital and a platform that allows individuals and small businesses to transfer money between international accounts at much lower cost than traditional banks.

For some, Fintech will revolutionize the traditional banking industry as we know it today, but for the moment, the platforms finance mostly risky projects. At one end of the platform, there are retail investors who choose whom they would like to finance. On the other end, there are SMEs and start-ups that do not go to banks, often because they cannot provide standard guarantees. The platforms generate profits from the origination and servicing fees that they charge to funders and fundraisers. The investors bear all investment risks, providing a natural 'bail-in' mechanism. Equity crowdfunding platforms can complement angel- and venture-capital, by allowing individuals to invest in start-ups and buy shares which are not listed on the regulated stock market.

For the moment the scale of finance channelled through Fintech platforms remains limited (Figure 1) and peer-to-peer lending to SMEs lags far behind consumer lending. The [2017 Economic Survey of Estonia] stresses that a sustainable development of this ‘alternative finance’ requires a creation of a level playing field between the traditional and the alternative sources of credit in terms of access to information, regulation, and taxation.

Figure 1. Estonia is a frontrunner in alternative finance but amounts are low

Volumes, in euros per capita, 2015



Note: Alternative finance includes peer-to-peer lending, equity crowdfunding, donation and reward crowdfunding, as well as balance sheet lending.

Source: Cambridge Centre for Alternative Finance.

To build confidence in these new financing forms, a necessary condition to their development, consumer protection of Fintech users should be reinforced. The Estonian authorities should introduce licencing and transparency requirements and require the platforms to have resolution plans in place to ensure that repayments continue to be collected in case of bankruptcy. By establishing a well-designed credit information-sharing scheme covering all borrowers (firms and individuals) it could help to move the industry forward, by facilitating the use of big data and algorithms to screen and monitor borrowers. Finally, the level playing field should be established also when it comes to taxes. Taxation of investment via Fintech platforms should be harmonised with that of bond and equity securities, by allowing investors to deduct their losses from their income tax base.

References

OECD (2017), *OECD Economic Survey of Estonia*, OECD Publishing, Paris.