The Canadian fintech landscape

Is regulatory change sufficient to promote innovation?

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Fintech is changing the global financial landscape. In addition to increasing competition and driving innovation for traditional banks, insurers and asset managers, the rise of fintech activity is also spurring needed regulatory change.

Regulatory bodies in nations around the world are investigating and implementing banking policy modifications in order to attract established fintech players and encourage the growth of local fintech, both as a startup ecosystem and within traditional financial institutions. While fintech-friendly regulatory changes in Europe and Asia dominate the headlines, change is also coming to Canada. Recent and anticipated changes to Canadian financial regulations look to provide fintechs, financial institutions and other potential players with new and broader powers to encourage innovation, as well as pave the way for open banking.

According to initial assessments, these regulatory changes may have a significant impact on the Canadian financial services sector. But, given the swift pace of global innovation, will the changes be sufficient to earn Canada a place in an increasingly competitive global fintech ecosystem?

Fintech evolution across the globe

The past few years have seen significant regulatory changes in regions around the world. 2018 introduced the formal launch of open banking in the European Union (EU) under the revised Payment Services Directive (PSD2), and in the UK through the Competition and Markets Authority's Open Banking mandate. The new regulations mandate banks to share customers' private and financial data with third parties, such as fintechs and challenger banks, subject to customer approval. These regulations were put in place with the intent to reduce stagnation of the European financial sector by evening the playing field for non-traditional financial players.

Many of the financial regulators around the world have taken significant steps to create an environment that encourages and attracts fintech innovation. Regulators such as the Financial Conduct Authority in the UK, the Monetary Authority of Singapore and, in Canada, the Ontario Securities Commission and Autorité des Marchés Financiers in Quebec, have all set up fintech sandboxes, where startups and established players can test new financial products and services. Canadian regulators, like the CSA, have also had a particularly open policy when it comes to sandboxes, allowing startups to well-established companies to register and or/obtain exemptive relief from securities requirements. Some examples include Initial Coin Offerings (ICOs) and cryptocurrency investment funds.

Financial players are also watching with interest, anticipating the announcement regarding the US Office of the Comptroller of the Currency's (OCC) Fintech Charter for licensing online lenders and other fintechs. While it was announced that the OCC would grant banking licences to fintechs in the US, legal challenges from regulators at the state level have delayed a formal ruling.[1]

Proposed changes in Canada

While Canada has a conservative banking culture and regulatory environment that protected the country during the 2008 global financial crisis, change is imperative to maintain pace with global innovation. The *2018 Budget Implementation Act*, Bill C-74, introduced proposed amendments to the *Bank Act*, *Trust and Loan Companies Act* and *Insurance Companies Act* to provide banks and other financial institutions with new or broader powers to:

1. Act as an agent or refer customers to a third party for the provision of financial services;
2. Invest in fintech companies that primarily, but not necessarily solely, provide financial services;
3. Collect, manipulate and transmit information without regulatory approval;

[1] https://www.reuters.com/article/us-usa-occ-otting/u-s-regulator-to-publish-fintech-charter-position-in-next-few-months-idUSKBN1HG2FA

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4. Engage in technology-related financial activities in-house or through a third party, and commercialize in-house developed activities or provide these to a third party; and

5. Provide identification, verification and authentication services.[2]

Bill C-74, including the relevant changes proposed in Part 6, Division 16, which contains proposed changes to the Bank Act has passed its third reading in Senate and obtained Royal Assent on June 21, 2018.

Impacts of changes on the Canadian financial sector

These changes will have a number of positive impacts on Canadian banks' and financial institutions' ability to engage in innovative fintech activities. A key highlight is the removal of current stifling obstacles to certain types of relationships between banks and fintechs. Many of these barriers, such as the need for a lengthy regulatory approval process for partnerships, are from a time when technology was not as integral to banking or financial services. The changes will allow for improved collaboration between banks and fintechs, better enable banks to use fintechs' products and services, reduce delays associated with regulatory approvals and enable financial institutions to further strengthen their investment in fintech-related technologies.[3]

The regulatory changes proposed through the review of the Federal Financial Sector Framework, including the *Bank Act*, also make significant moves toward an open banking framework, as seen in the EU through PSD2. The move to allow data sharing between providers and enable banks to refer customers to other entities levels the playing field for traditional and non-traditional providers of financial services, while creating unique opportunities for existing financial institutions. For example, Canadian banks can strengthen their market positions by acting as a platform, giving customers a single interface for all their financial services and products regardless of provider. Similar opportunities exist in the corporate financial services space, especially in accounting and lending.[4]

As a whole, the proposed policy updates look to create an environment that will open up the sector to greater competition and innovation without harming banks, and will ultimately benefit customers through greater choice and competition. In the Canadian Bankers Association's (CBA) response to the changes, they noted that they "fully support legislative changes that clarify, modernize and enhance the business powers of financial institutions"[5] and that the changes will "foster innovation in financial services, promote competition, and ensure consumers have access to better products and services."[6]

Potential privacy issues and other concerns

Despite positive industry response, there are some concerns around potential impacts that will likely need to be addressed. While the ability for financial institutions to refer customers to other entities is a key step on the road to open banking, such sharing makes privacy a central concern. Big questions arise as to whether customers will understand the risks associated with the transfer of personal and financial data, as well as the institutions' responsibilities with regard to the protection, use and storage of that data. All eyes are currently watching these factors play out in the EU and UK, and anticipating customer response in Canada.

Risks surrounding digital innovation and cyber vulnerabilities also come into play. While many banks and other financial services providers are already focused on addressing data privacy issues thanks to the impact of the EU's General Data Protection Regulation (GDPR), Canadian regulatory changes will undoubtedly result in further privacy issues for both banks and regulators to consider.

Another challenge associated with the regulatory changes is the potential impact to the complex interrelationships between regulators at the federal and provincial levels. Provincial legislators such as the Ontario Securities Commission (OSC) have put a lot of work into initiatives such as creating fintech regulatory sandboxes and launch pads. Federal regulators must now work with provincial agency leaders to coordinate and identify potential gaps, as well as any downstream impacts of a move to drive

[2] http://www.parl.ca/DocumentViewer/en/42-1/bill/C-74/royal-assent
[3] https://www.cba.ca/remarks-house-of-commons-2018-budget-implementation-act
[4] https://www.pymnts.com/news/b2b-payments/2018/flinks-canada-open-banking/
[5] https://cba.ca/canada-bank-act-review
[6] https://www.cba.ca/remarks-house-of-commons-2018-budget-implementation-act

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innovation through open banking. Concerns are not unfounded: our current regulatory context has served Canada's economic interests well during periods of risk and instability, making it difficult for some to support broader changes.

The road ahead

Regardless of current regulations, the Canadian fintech ecosystem is thriving – and with changes on the horizon, the pace of innovation and investment in Canadian fintech is expected to accelerate.

The Canadian financial landscape, like others around the world, is ripe for disruption. An increase in market competition and greater opportunities for innovation and collaboration throughout the sector can only be good for financial institutions, fintechs and Canadian banking customers alike.

While the long-term changes of current and anticipated regulatory changes have yet to play out, global trends should give Canadian financial players insight into the changing landscape. In the coming months, institutions should keep a close eye on other global regions – and be ready for similar patterns to occur here in our local market.

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