

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

Digital Disruption in Financial Markets – Note by Canada

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This document reproduces a written contribution from Canada submitted for Item 5 of the 131st OECD Competition committee meeting on 5-7 June 2019.

More documents related to this discussion can be found at

<http://www.oecd.org/daf/competition/digital-disruption-in-financial-markets.htm>

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1. Introduction

1. Canada's Competition Bureau (the "**Bureau**") is pleased to provide this submission for the Organisation for Economic Co-operation and Development ("**OECD**") Competition Committee's discussion on "FinTech and Disruptive Innovation in Financial Markets" at its forthcoming meeting on June 5, 2019. This submission builds upon information set out in the Bureau's previous [submission](#) to the OECD' Competition Committee Working Party No 2 on Competition and Regulation.
2. The Bureau, headed by the Commissioner of Competition (the "**Commissioner**"), is an independent law enforcement agency of the Federal Government of Canada responsible for the administration and enforcement of the [Competition Act](#) (the "**Act**") and certain other statutes. As part of its mandate, the Bureau participates in a wide range of activities to promote and advocate the benefits of a competitive marketplace.
3. Technology-led innovation in the financial services sector ("**FinTech**") is transforming what financial services are, and how they are delivered to consumers. The innovative technologies and business models being introduced by new entrants promise to increase choice, improve convenience and lower prices for businesses and consumers alike.
4. The Bureau has played a strong role in promoting competition in Canadian policies and regulations governing the FinTech Sector. In December 2017, after an extensive 18-month study of the industry, the Bureau published its report on [Technology-led innovation in the Canadian financial services sector](#) (the "**FinTech Market Report**"). The findings of the study were based on a review of publicly available information, as well as submissions and over 130 interviews with stakeholders.
5. The FinTech Market Study made 30 recommendations to Canada's regulators and policy-makers. Nineteen recommendations identified specific, technical improvements for retail payments and payment systems; investment dealing and advice; and lending and equity crowdfunding. Eleven recommendations focused more broadly on how to strike the right balance in regulation to ensure Canadians are protected while promoting innovation through competition.
6. In addition to the FinTech Market Study, the Bureau has also provided [eight submissions](#) to Canadian regulators since 2016. These submissions have touched on a variety of issues, from a review of the merits of open banking, to positioning the financial sector for the future, modernizing the payments framework and the securities framework, and updating the Canadian anti-money laundering and anti-terrorist financing regime.
7. [Significant progress](#) has since been made by Canadian policy-makers and regulators in modernizing the financial services sector. This includes several initiatives that reflect the FinTech Market Study's recommendations, described in more detail below.

2. Overview of the Competition Bureau's FinTech Market Study

8. The Bureau decided to study Canada's financial services sector for three primary reasons. First, during the Bureau's public consultations in 2013, financial services were

identified as an area of focus for potential advocacy initiatives. Second, the sector itself is an important pillar in the Canadian economy. Financial services contribute approximately 7% to Canada's gross domestic product (as of May 2017) and financial services account for nearly 800,000 Canadian jobs (2015 figures). Third, financial services play a significant role in the day-to-day life of most Canadians, whether they are receiving or making payments, borrowing, spending, saving or investing.

9. The Bureau sought to understand why FinTech adoption appears to be higher in other jurisdictions than in Canada. The Bureau used the information collected through the study to assess the impact of FinTech innovation on the competitive landscape, identify the barriers to entry and expansion of FinTech in Canada, and determine whether regulatory changes were needed to promote greater competition and innovation in the financial services sector.

10. To ensure relevance for Canadians, the study focused on innovations that affect the way Canadian consumers and businesses commonly encounter financial products and services, with a focus on three broad service categories:

- retail payments and the retail payments system
- lending and equity crowdfunding
- investment dealing and advice

11. The study also noted that unlike other jurisdictions, Canada lacks a clear and unified policy lead or regulatory framework for FinTech. This makes it more difficult for the country to take a national, unified approach to encourage FinTech development, or improve the scope and applicability of existing initiatives.

2.1. Retail Payments and the Retail Payment System

12. Canadian consumers and businesses rely on retail payments for a variety of needs. This includes purchasing goods and services, making financial investments, paying wages, and sending money to each other. Retail payments include not only familiar payment methods such as cheques, electronic point-of-sale (“POS”) debit transactions, and electronic funds transfers or credit card transactions, but also a number of new technologies and business models (e.g. mobile wallets) offered by payment service providers (“PSPs”).

13. The study found that there were many barriers to entry and growth facing competitors in retail payments, including both new entrants and incumbent firms. Regulatory gaps between regulated PSPs and new, potentially unregulated, firms attempting to enter the space can create uncertainty for consumers and entrants. This uncertainty may reduce incentives for consumers and merchants to switch to innovative payment methods. There were also non-regulatory barriers, with some new entrants lacking easily available access to the core banking services and payments infrastructure required to underpin a FinTech product or service. The Bureau found that while some barriers would need to be overcome by the FinTech firms on their own, others might require regulatory intervention.

14. The Bureau also noted positive developments in the framework for retail payment systems. This included a new regulatory oversight framework being developed by the Department of Finance Canada (“**Finance Canada**”) to help promote innovation in the financial services sector, and Payments Canada's (the organization responsible for

operating and overseeing Canada's national payment systems) announcement of plans to develop a modernized, real-time retail payments system.

2.2. Lending and Equity Crowd-funding

15. Since the 2008 financial crisis, increasing risk aversion from financial institutions has led to a tightening of credit markets, particularly for small and medium-sized enterprises (“SMEs”). Many smaller and newer businesses have difficulty accessing financing from formal sources such as retail banks because they lack the credit history or collateral needed to secure a loan. As a result, nearly half of Canadian SMEs rely on informal sources such as personal financing, loans from friends and family, retained earnings and personal savings.

16. FinTech firms offer new forms of SME financing, with two main business models emerging: peer-to-peer (“P2P”) lending, and equity crowdfunding. The study however found that providers of these platforms face significant regulatory and non-regulatory barriers that may be inhibiting their market entry and growth. In terms of non-regulatory barriers, Canada's strong regulated banking system may result in SMEs lacking the desire to venture out of that system and try new forms of financing. In addition, consumer confidence may be a major barrier to overcome due to the lack of clear regulation governing P2P lending.

17. Due to the confederated nature of Canadian laws, variations in laws exist from one province to the next. As a result, it can be difficult for FinTech-based financing platforms to navigate the various federal and provincial laws that might apply to their business models. At the same time, technology-driven financing platforms are subject to the same regulations as their bricks-and-mortar counterparts, despite potentially different risks associated with their business models. Finally, while some FinTech firms in this marketplace have partnered with incumbent financial institutions, these arrangements are subject to regulations governing outsourcing by federally regulated financial institutions, which have processes and policies that are difficult for many FinTech companies to follow.

2.3. Investment Dealing and Advice

18. While investment advice has traditionally been supplied in person by investment professionals, shifting customer demand and the advent of mobile Internet have led to a new wave of tools for investors. Leveraging less expensive exchange-traded funds and operating predominantly on a fee-only basis (rather than earning a commission from each fund), online advisors (also called “robo-advisors”) have established themselves as low-cost alternatives to traditional advisors. Using model portfolios based on model investor profiles, they can reduce the time and cost of meeting with clients, and put pressure on traditional advisors to lower their fees so they can remain competitive.

19. The study found that while a handful of robo-advisors have been successful, there are still many barriers to their growth. In any industry, consumers will consider switching to a competitive offering if they can easily understand the cost and benefits of their decision. This can be difficult in the investment dealing and advice industry, where fees are commonly embedded in the management expense ratio. Compounding this challenge, these fees are often not discussed or understood by investors. There are also tangible costs that may discourage switching, such as the time and expense of setting up new accounts and transferring assets. In addition, robo-advisors may not be able to deliver the true online

experience consumers might expect, particularly given that electronic forms and signatures are not yet accepted throughout the industry.

20. Certain regulatory requirements may also inhibit robo-advisors from fully leveraging technological advances and automation. For example, investment dealers must ensure any investments offered are suitable for a client's risk tolerance and investment objectives. Securities law requires that a meaningful discussion be held by an advisor to obtain the necessary information; it may be unclear how requirements designed for in-person interactions should be applied in an online-only setting. Robo-advisors must also hire registered advising representatives to be involved in portfolio decision-making, increasing costs and impeding the development of automated solutions.

3. Recommendations of the FinTech Market Study

21. The Bureau developed eleven broad recommendations for financial sector regulatory authorities and policymakers to ensure future regulatory change creates space for innovation in this important sector of the Canadian economy. These recommendations can be categorized as follows:

- Recommendations aimed at **promoting competitive neutrality and flexibility** in financial services markets, such that all firms can compete on a level playing field.
- Recommendations that **encourage more co-operation and collaboration** among Canada's various policy-makers and regulators at different levels of government.
- Recommendations aimed at **promoting access** to important infrastructure, services, systems, and data for competitors.

22. Certain recommendations set out in the study encourage the development of regulations that are principled-based and technology-neutral, allowing incumbent firms and new entrants to compete on an equal footing. Companies performing the same functions should carry the same regulatory burden, and be required to afford consumers the same protections. This approach also allows regulators flexibility in developing and adapting their frameworks to account not only for existing technologies, but also innovations that may emerge in the future. Regulations should also be proportional to risk; functions whose failure poses lower risks to the financial system should not necessarily face the same strict oversight as those whose failure poses higher risks.

23. Under such a regulatory approach, participants in the industry would be regulated not on the basis of what type of company they are (bank, FinTech, "BigTech", or other), but rather based on the particular financial services and functions that they offer. In practice, certain companies are more likely to offer a particular set of services matched to their specific abilities and objectives, but in principle any industry participant could offer any financial service so long as they meet the regulatory requirements associated with that service. This offers a level playing field not only to existing competitors, but also to innovative entrants that may emerge with new technologies and business models to offer better options and/or prices to consumers. At the same time, consumers can rest assured that they are entitled to the same protections when they make use of financial services, regardless of who offers that service. This could help consumers build trust in unfamiliar technologies, reducing barriers to entry and growth.

24. Other recommendations focused on the need for improved co-operation and collaboration among Canada's policy-makers and regulators. Under Canadian federalism,

jurisdiction over the financial services sector is not unified at the national level, but rather allocated between the federal government and provincial governments. As a result, various aspects of financial services regulation, including the regulation of FinTech, are subject to different regulatory regimes across the country. This can lead to an increased compliance burden, especially for smaller competitors. The importance of harmonization lies in its ability to streamline and simplify these compliance obligations. For example, securities regulation falls under provincial jurisdiction, but much work has been done by the Canadian Securities Administrators to harmonize these regulations across Canada.

25. The final set of recommendations reflect the need for competitors to have access to the infrastructure, services, and data needed to operate and innovate effectively in financial services markets. In certain cases, regulatory requirements may be used as justification for denying access to core infrastructure like the payments system, such that regulation acts as a barrier to competition and innovation. In other cases, regulation may be useful to ensure that FinTechs and other firms have access to the services and data they need to facilitate customer switching and provide innovative financial products, such as the possibilities offered by “open banking”.

4. Regulatory Developments in the Financial Services Sector

26. In December 2018, the Bureau published a [Progress Report](#) on FinTech to examine the extent to which financial services regulators were implementing the eleven broad recommendations set out in the FinTech Market Report. The Bureau found that there had been many positive developments, with federal and provincial policy-makers and regulators working to adapt their frameworks to the challenges and opportunities offered by emerging innovations.

27. Of most relevance to the OECD’s upcoming discussion on digital disruptions in the financial sector, the Bureau observed a number of regulatory initiatives designed to apply a competitively neutral approach to regulating industry participants. Regulators are working to structure their frameworks in terms of what companies offer (function-based), instead of who they are (entity-based). Regulators are also thinking ahead in terms of designing rules that are technology-neutral, principles-based and risk-based, so as to avoid requirements that may be quickly become outdated as a result of rapid advancements in technology.

28. Some of these regulatory developments include:

- In 2017, Finance Canada's [consultation](#) on a new retail payment oversight framework proposed a new set of rules focused on the payment process. From the moment a consumer taps their credit or debit card to the moment when the vendor receives the funds, there is a certain level of risk at each stage of the process. The new framework adapts its rules to match the level of risk at every stage.
- In February 2018, the British Columbia Securities Commission (“BCSC”) launched a [consultation](#) on its Securities Law Framework for Fintech Regulation focused on a number of regulatory challenges. The Bureau's [submission](#) applauded the BCSC's consideration of automation to meet compliance obligations for “know-your-client” assessments. This signals a shift away from relying on face-to-face conversations to ensure compliance and paves the way for automation and artificial intelligence to improve the quality and efficiency of investment advice, for

example, through a broader variety of options at different prices that are tailored to each customer.

- In February 2018, the Government of Canada introduced amendments to the [Bank Act](#) (and related legislation) to allow trust companies, credit unions and co-operatives to use words like "bank" and "banking" to promote their own products and services. This also allows these entities to provide clearer descriptions of their services to consumers. The amendments also expanded the scope of technology-related activities banks can participate in so they are not as restricted simply by virtue of being banks. These changes provide greater flexibility for such firms to enter into new arrangements with third parties, such as FinTech firms.
- In May 2018, Finance Canada launched a [consultation](#) on the [Canadian Payments Act](#). It builds on a proposed oversight regime that takes into account the specific risks associated with processing payments. In particular, the consultation highlights important oversight principles for the new "Real-Time Rail"¹, such as requiring that any PSP holding customer funds overnight (or longer) must place those funds in a trust account with an institution protected by a deposit insurance regime. In this way, consumers can be assured that their funds are safe, regardless of how they make payment, whether by credit card, debit, e-transfer or mobile app. In the Bureau's [submission](#) to the consultation, it advised that Finance Canada's principles-based approach will ensure customers are protected and oversight can evolve as Canadians explore new ways to pay.

29. In January 2019, Finance Canada launched a [review into the merits of open banking](#), focused around Canada's three core financial sector policy objectives of efficiency, utility, and security. In its [submission](#) to the consultation, the Bureau advised that open banking has the potential to deliver significant benefits to consumers and businesses through increased competition and innovation in Canada's financial sector, as well as potentially decreasing switching costs and barriers to entry. The Bureau also supported Finance Canada's view that some of the privacy and data protection risks associated with open banking are not specific to open banking, but stem from digital transformation and increased commercial use of data more generally. As such, regulatory efforts in this sector will need to take into account other government activities, including [ongoing initiatives](#) aimed at reviewing or modernizing Canada's overarching privacy and data protection frameworks.

30. While progress also has been made in terms of harmonizing regulations across geographic borders and encouraging collaboration among regulators, some challenges remain in this area. In particular, Canada still lacks a clear policy lead on FinTech related issues in Canada. A FinTech policy lead would give FinTech firms a one-stop resource for information and encourage greater investment in innovative businesses.

5. Conclusion

31. FinTech has the potential to significantly change the way Canadians access financial services. It promises to increase choice and convenience, while also lowering

¹ Real-Time Rail describes an always-on payments infrastructure that supports immediate payments. See Payments Canada, "[Payments Canada releases detailed future view of Canadian payments](#)" (December 21, 2017).

prices and frictions existing in the marketplace today. Regulators must nonetheless ensure that they keep pace with innovation to ensure regulation continues to effectively meet its objectives.

32. To foster innovation through competition, the Bureau encourages regulators to develop principles-based frameworks that promote a competitive playing field between industry participants. Participants should be subject to the same rules based on the services that they offer, the risks they bear and the functions they perform, rather than their traditional place in the sector, their size, or the technologies and business models they use. A principles-based framework also protects consumers by ensuring that they have access to the same protections and safeguards, regardless of the service provider they use.

33. The Bureau is encouraged by significant steps taken by regulators at the federal and provincial levels to welcome FinTech to the sector and examine barriers to these technologies, both regulatory and non-regulatory. Initiatives such as Finance Canada's consultation on open banking and the BCSC's consideration of automation to allow firms to meet compliance obligations; the various sandbox and concierge services being introduced by securities regulators; and working groups and strategies to support FinTech that have been established at provincial and federal levels of government, are all promising developments. The Bureau expects to continue working with regulators as FinTech and other innovations continue to emerge in the financial services sector.