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The Advisory Committee to the
Open Banking Review/Financial Institutions Division
The Financial Sector Policy Branch
Department of Finance Canada
90 Elgin Street, Ottawa, ON K1A 0G5

February 5, 2019

To Whom It May Concern:

Re: A Review into the Merits of Open Banking

CONTEXT:

In January 2019 the Department of Finance Canada invited the Canadian public to submit its comments regarding the Merits of Open Banking.

Ferst Capital Partners ("**FCP**") is a Canadian investment firm focused exclusively on Canadian fintech investment and innovation. We provide funding and strategic support for Canadian early stage fintech businesses, as well as ideating and incubating our own fintech companies.

Ferst Capital Partners is deeply embedded in the Canadian fintech community and have previously provided submissions and consultations to the Department of Finance Canada, the Fintech Interdepartmental Committee – Government of Canada, the Federal Competition Bureau, Ministère des Finances de Quebec, and the Canadian Securities Administrators.

As such we are pleased to make this submission to comment on the Review into the Merits of Open Banking.

CONSENT:

We consent to the disclosure of our comments, without the removal of our identity or personal identifiers, with the exception of the section clearly outlined below.

The global financial services industry is undergoing a secular technology, business model and regulatory shift driven in large part by new ways to effectively access, use, shape and monetize data. Data has become the raw material of the modern economy. As a country, how we approach open banking and deal with questions such as data ownership, control, and usage will have a profound effect on how we will shape our economy going forward.

It is our view that open banking, or more generally, enabling consumers the ability to access all of their financial and transaction data wherever it resides is not only a fundamental right but also foundational lever required to support competition and innovation. While other nations are moving relatively quickly in implementing a full open banking system, we will be left behind with inaction and run the risk of having the new generation of Canadian financial services companies being based elsewhere from Canada.

Would open banking provide meaningful benefits to and improve outcomes for Canadians? In what ways?

The consultation document 'A Review into the Merits of Open Banking' which accompanied the call for comments outline many possible benefits which can result from an open banking system. We are completely in agreement with the many important benefits as outlined.

Are we currently seeing these benefits and improved outcomes in Canada?

As a direct to consumer fintech investor taking active roles building early stage companies, we are seeing Canadian direct to consumer (B2C) FinTechs struggle to create companies and achieve sustainable growth. To maintain our investment thesis and inform our allocation decisions, FCP prepares and publishes a map of Canadian fintech startups on a yearly basis.[1] Our analysis highlights the lack of traction on behalf of Canadian B2C startups. Below is an excerpt from our latest release in September 2018:

> B2B (business-to-business) startups have achieved a significantly higher success rate than B2C (business-to-consumer) startups. Even though B2B startups make up 54% of all Canadian FinTechs, they add up to 75% of all startups we tracked in the expansion stage. On the other hand, B2C companies make up 35% of all FinTechs but only 18% of all startups in the expansion stage. These are significant differences.
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> While all FinTechs face common challenges, including the difficulty of forming partnerships with incumbents and heavy customer acquisition costs, these challenges appear to be exacerbated when going direct to consumer. As a result, several of the FinTech-focused funds in this country tend to favour B2B companies, which now makes funding a bigger challenge for B2C companies.

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[1] https://blog.ferstcapital.com/2018/11/14/the-state-of-canadian-fintech-in-4-charts-2/

Investors will look at these numbers as validation for their B2B-focused strategies while B2C entrepreneurs will argue that they need more capital support to be successful.

While there are other important factors which contribute to the low level of B2C Fintechs in Canada - such as a low level of institutional investor appetite for B2C startups, a significant deficit in technological capability from partnering incumbents and a lack of desire on the part of incumbent financial institutions to innovate their consumer offerings – we attribute much of the deficit to a lack of a workable open banking system in Canada. In fact, we are seeing tangible benefits accrue to consumers in jurisdictions with a more advanced open banking system than our own.

In order for Canadians to feel confident in an open banking system, how should risks related to consumer protection, privacy, cyber security and financial stability be managed?

Concerns have been raised, particularly by financial institutions and organizations representing financial institutions, in regards to open banking which generally centre around security, protection and privacy. While we share these concerns, it is our opinion that a rules-based open banking system offers far better tools to deal with these challenges.

Regarding security, we believe that empowering consumers with choice is not mutually exclusive from keeping their data safe. Through the use of data-aggregators or 'screen-scrapers', consumers are willing at an increasing rate to not only risk violating their user terms but also use far less secure methods to provide their data to 3rd party services. For this reason, we believe that a standards-based implantation of APIs will keep consumer data far safer then under the current closed system.

In terms of privacy, we believe that it is only under an open banking system that consumers finally will have true control over their own data. In fact, many of the motivations behind European PSD2/XS2A legislation were to ensure consumers had control over their own data. Further, while all Canadian businesses must comply with The Personal Information Protection and Electronic Documents Act ("PIPEDA") there is very little oversight as to whether businesses are compliant. We believe open banking is an excellent opportunity to bring privacy obligations into the regulatory fold by empowering regulators to audit for compliance.

Should payments initiation form part of an open banking framework?

Fintech innovation is characterized not only by digitizing existing services but by leveraging customer data sets in order to personalize financial products and services in a cost efficient manner. Payments, and the ability to move, pay, and transfer money in a seamless and frictionless manner is a critical element of this intermediation and a basic part of the customer journey. If we wish to realize the benefits of open banking it is imperative that payments initiation form part of the open banking framework.

What data types should be included within an open banking framework?

While it may be outside the purview of this consultation – which is focused primarily on customer transaction data created through current accounts, debit cards and credit cards – we believe enabling consumers the ability to access all of their financial data wherever it resides is not only a fundamental right but also foundational lever required to support competition and innovation. While transaction data is an important starting point we would be remiss to not consider other financial data sets as part of an open banking framework. As we will argue below, the lack of a workable market-based open banking system in Canada is due in large part to competitive factors. Incumbent financial institutions have shown little appetite to allow access to their customer's data. If we wish to truly enjoy the benefits created by access to open data we should legislate the opening of all financial data, not just transaction data. Banks will not do this on their own. A few examples of financial data that should be included in an open banking framework include: payments initiation and data, wealth management and securities portfolio data, insurance policy and claim data, loan and mortgage data, and KYC and AML data.

Of considerable concern to us is the slow pace in which we are undertaking to create an open banking framework in Canada. We are years behind the UK, the EU, Australia and various Asian countries in this regard. As a result, we are seeing far more fintech innovation in those jurisdictions. To reverse this trend, we believe strongly that our open banking framework must be far bolder – including all financial data - then those being rolled out elsewhere. We believe this is an excellent opportunity to catch and ultimately surpass those who are ahead of us.

What effects could open banking have on the stability of our financial system and prudential risk?

We believe this to be an area of both opportunity as well as risk. On the one hand we see open banking and access to large sets of anonymized transaction data to hold great promise to aid government and regulators monitor consumer spending, borrower default rates and money flows in real time.

On the other hand, we understand the risk in the case where open banking, particularly if payment initiation forms part of the opening banking framework, increases the velocity of financial flows and market share changes such that it causes prudential risks. This risk is particularly acute within Canada whereby our financial services are highly concentrated and large and rapid market share change can have an amplified effect on the ecosystem. While it is still early days and therefore we have not seen the full effect of open banking in jurisdictions that have legislated frameworks, we have also yet to see negative consequences. We thus agree the risks are concerning and we should consider strategies to mitigate them.

On shouldering the costs of implementing an open banking system

We often hear from FRFIs (Federally regulated financial institutions) regarding their concerns around the technological and compliance burden, as well as cost imposed on them by open banking, particularly in light of their already onerous compliance obligations.

We believe their concerns in regards to cost are overstated. An assessment made by the Open Data Institute for HM Treasury in the United Kingdom estimated the actual cost to implement the technology necessary for open banking was low and could take less than a year to implement.[2]

Furthermore, it is our view that open data should not be viewed as advantageous only to FinTechs. In fact, with their considerable market power and favourable reputation amongst Canadian consumers, FRFIs are well positioned to capitalize upon the new products and services that can be created through open banking as well as the impending ability of serving previously underserved customers. Rather then see it as a burden, it should be seen as an opportunity. Furthermore, it is our view that digitization and the rapid creation of large open networks of online users is an enormous threat to incumbent organizations that remain closed and do not innovate quickly. The fact that the digitization of financial services will take place is no longer being questioned. The question is now whether we will do it ourselves or have it done to us by companies from other countries. In this light, the technological and compliance burden must be shouldered by our financial services industry if our domestic financial services industry were to remain relevant over the next decades.

If you are of the view that Canada should move forward with implementing an open banking system, what role and steps are appropriate for the federal government to take in the implementation of open banking?

Regarding the debate around how open banking should be implemented in Canada there is the question of whether it should be a market-based or a legislated solution. We believe, due to the competitive dynamics within financial services more broadly, and within banking more specifically where the industry is dominated by a small group of large FRFIs, there should be a policy based or legislated solution. The United Kingdom's Competition and Markets Authority ("CMA") launched a market investigation in 2014 and published a report in 2016 which found that the market for personal and small business banking had all the characteristics of an uncompetitive market that was not operating in the best interests of the consumer. The report concluded that in a highly concentrated market, it is in the best interests of the consumer to mandate open banking reforms rather than wait for a market-based solution[3].

Up to now, we have seen very little movement on the part of FRFIs to open their systems through APIs and allow customers to access their data. In the limited cases where FRFIs have done so it has only been on a proprietary basis (the FRFI chooses their 3rd party partner) as opposed to a truly open basis (the customer chooses their 3rd party partners). We believe it is both unhealthy and limiting for financial innovation to be decided within the boardrooms of our largest financial institutions.

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[2] The Open Data Institute, "Data Sharing and Open Data for Banks: A report for HM Treasury and Cabinet Office". September 2014.
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/382273/141202_API_Report_FINAL.PDF

[3] Competition and Markets Authority, "Retail Banking Market Investigation: Final Report", August 9, 2016.
https://assets.publishing.service.gov.uk/media/57ac9667e5274a0f6c00007a/retail-banking-market-investigation-full-final-report.pdf

Furthermore, in the absence of a legislated open banking solution and direct access to customer data, the market is forced to resort to sub-optimal short-term solutions, such as data aggregation or 'screen scraping' to provide consumers with the services they are demanding.

FCP is on the front lines of this market dynamic and we see the limiting effect of this problem every day. To observe the manner in which a lack of open banking in Canada affects innovation, stifles competition and limits the choice of Canadian consumers it is instructive to observe the experience of actual fintech services as they seek to acquire customers and provide services. An excellent case study is Mylo.

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CONCLUSION

While we are heartened to see the interest on the part of the Department of Finance Canada in exploring the benefits that will come with open banking, we caution that fintech is a competitive and global movement that is rapidly evolving. We are deeply concerned that we are moving too slowly in Canada to implement the levers required to meet this competition. We must understand the problems, determine the solutions and move swiftly and with conviction.

Ferst Capital Partners thanks you for the opportunity to make this submission. If you require further clarification on any of our positions or wish to discuss further we encourage you to reach out at your convenience. It would be our pleasure to work with the Department in any way that we can be useful.

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