

OPEN BANKING

FINTECH GROWTH SYNDICATE

Our Comments on
“A Review into the Merits
of Open Banking”

February 11, 2019



PRIVACY & CONFIDENTIALITY

FinTech Growth Syndicate (FGS) has prepared comments on Consultation Document “A Review into the Merits of Open Banking” for the Department of Finance Canada. FinTech Growth Syndicate understands submissions will be shared in their entirety with both the Advisory Committee and the Department. FinTech Growth Syndicate understands that the Department intends to make public some or all of the responses received and/or may provide summaries in its public documents. FinTech Growth Syndicate consents to the Department making this commentary public.

OPEN BANKING IN



CANADA

INTRODUCTION

Our Position

FinTech Growth Syndicate (FGS) is in support of an open banking system in Canada. Open banking will be highly beneficial to consumers, small businesses, FinTechs, tech companies, and financial institutions. Open banking would provide a holistic view for authorized stakeholders into data sets that would enable more informed decision-making not otherwise possible or considered very cumbersome today.

OPEN BANKING WILL NEED TO BE EMBRACED BY ALL KEY STAKEHOLDERS IN CANADA'S FINANCIAL ECOSYSTEM, INCLUDING FINANCIAL INSTITUTIONS.

The large Canadian banks dominate the financial services market and serve the banking needs of most Canadians. FGS believes this market dominance creates barriers for Canadians to access and adopt innovative new products. Today, too many individuals and business-owners are declined a product or service such as a small business loan, a mortgage or financial planner because of their perceived risk based on the legacy credit scoring, risk management, and subjective processes the large Canadian banks currently have in place. Without open banking, the Canadian financial services industry and large new FinTech market will not thrive. The current banking model limits consumer access to new products and services and increases the risk of failure of new small businesses.

As it stands, the articulated value proposition of open banking for financial institutions in the Consultation Document seems weak in comparison to the benefits that could be realized by other stakeholder groups. FGS believes this understated value proposition is an area that needs further analysis. In today's exponentially changing global economy, the risk and impact of not moving forward to offer consumers choice and convenience will open the door to global tech giants and other new entrants to enter the financial

services space and rapidly compete. The prevalence and use of Amazon, Apple, Google, Facebook and PayPal financial products (to name a few) in Canada mostly with respect to channel management, but shifting very quickly to payments and financial management, is an empirical data point that cannot be ignored when considering the competitiveness of our market. In addition, the entrance of Chinese payment and e-commerce solutions into Canada such as Alipay/Alibaba, WeChat Pay and UnionPay, to enable Chinese students, residents and visitors to transact in Canada via their Chinese bank accounts, is one of the largest competitive threats to Canadian financial technology and products.

Canadian financial technology and products currently cannot compete with the convenience, frictionless customer experience, digital enablement, and choice through access to both multiple financial products and non-financial products through mobile devices offered by tech giants and Chinese companies. We believe it is a foregone conclusion that this type of digital interaction is the future. And we believe that Canada is already too far behind other financial markets and requires immediate enforcement by regulators to break the hold of the oligopoly and

allow a level and competitive playing field to emerge in banking that is driven by consumer choice.

Financial institutions are beginning to understand how open banking benefits them. It is our opinion that RBC, through the launch of developer platforms, RBC Ventures and RBC Reach, which are all ways to engage digitally that benefit their existing and new customers, is a strong sign that they will lead when open banking is regulated. National Bank has stated they believe it is imperative that they do not wait for regulatory change, but in fact lead and provide the benefits now. Credit Unions are launching digital banks, gaining new banking licences and partnering with FinTechs rapidly however, their collective reach today is a fraction of the top 6 banks, and building awareness for these options more broadly amongst Canadians is akin to what the new FinTechs are challenged by. The cost of acquisition of a new customer is very high and out of reach.

Given the complexities of open banking, consumer options should be clear, simple, and easily accessible. The trust of a large portion of consumers is a fundamental necessity in the adoption of open banking. Data breaches are far too common around the world, and the general sentiment towards corporate accountability with handling sensitive data is deteriorating. Legislation that focuses on corporate accountability and consumer rights is vital in the success of open banking. Financial institutions today clearly provide a level of security, safety and prevention of fraud at a high cost, when compared to new or challenger banks or FinTechs, must

**OPEN BANKING
LEGISLATION SHOULD
BE DEVELOPED WITH
THE CONSUMER AT
THE CENTER.**



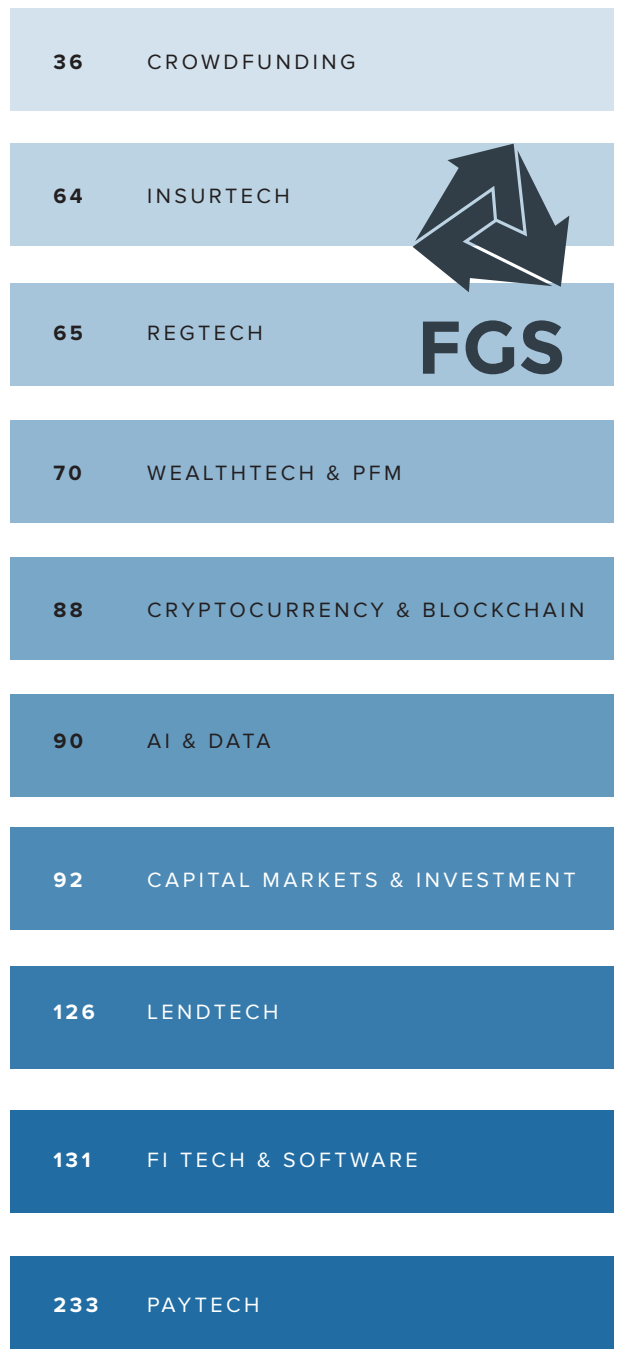
be a consideration for regulatory review. Canadians will need to feel as protected from one bank to another.

The UK implemented open banking regulations as a response to the economic failures that followed the 2008 financial crisis. The global financial crisis did not impact the Canadian economy as severely as the US, the UK and other markets. Could this be attributed to the current regulations governing, technology utilized by, and consumer sentiment towards our banks? FGS believes that was not the case. Perhaps the financial crisis was the early warning signal that technology was beginning to evolve faster than expected. The lack of automation, prevalence of manual intervention, subjective decision-making, and software that is no longer supported, are much bigger risks to our financial markets at this very important time.

Canadian government, regulators and policy makers must push quickly and aggressively toward implementing rules that mandate financial institutions to implement open banking in order to foster innovation, competition, and inclusion of the remarkable FinTech ecosystem we have created. We have approximately 1,000 FinTech companies operating in Canada as you can see by the image to the right. More than 50% of those companies are early-stage new entrants that require consumer adoption to stay in business. These FinTech companies represent a large portion of the Canadian economy, jobs and future potential. Open banking will open the access to consumers and businesses, creating a competitive platform.

995

FINTECH COMPANIES IN CANADA*



*For the purpose of this data, the total was a snapshot of the FinTech space in Q3 2018.

We do not believe that there is a case to be made that open banking will punish financial institutions, but rather that it will facilitate the necessary requirements to create a strong technologically advanced financial sector. The incumbents in our ecosystem have become complacent with outdated technologies and legacy systems, impeding the development of Canada as a technology leader. They are generating massive profits, increased revenues, and are slow, if not resistant, to change. And, they are no longer too big to fail in the presence of large tech companies who are more nimble, have lower costs to operate, and deliver a far superior experience.

The strength of Canada's financial sector is at risk as we fall behind in an increasingly data-driven global economy, and large new entrants like global tech giants are advancing quickly into financial services. Complacency is not an option - the time to take action is now. Careful strides instead of great leaps are important in creating a solid open banking framework. We commend the Department of Finance for taking steps toward the possibility of an open banking system that would benefit all Canadians.

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

FGS believes open banking would provide meaningful benefits and improve outcomes

for Canadians. Building upon the benefits presented in the Consultation Document, we believe open banking would increase the specialization and effectiveness of the financial sector in Canada. Open banking would offer the necessary inputs for all stakeholders in the financial ecosystem and create a scenario where the financial services industry achieves its highest potential through increased transparency and competition. It is our view that increased competition would lead to improved and more personalized banking offerings for consumers. Increased competition also creates more choices for consumers while enabling them to maintain ownership and control over their transactional data. We believe open banking would provide Canadians with a holistic view of their financial standing in real-time, which would support fiscally responsible decision-making while maintaining trusted relationships with their existing financial institutions. With a minimum of 995 choices of FinTech solutions, made directly or indirectly available to Canadians, FGS believes the benefits outweigh the risks.

More financial product and service choices in the market could help consumers choose the most cost effective options for them, thereby increasing disposable income for Canadians to fuel economic growth and development in different areas. FGS would like to encourage the review of payments regulations, to allow new entrants to gain access to the payments system without having an intermediary financial institution. Why? Because new entrants have lower cost options for

TOTAL FINTECHS IN CANADA



More banking options would also enable small businesses to get access to funding they are currently not aware exists. The availability of data could improve access to financial products and services for small businesses allowing them to better leverage their transactional data. This is especially true in the case of small business financing as small businesses can leverage their transactional data to prove their creditworthiness with greater speed and accuracy, as well as get access to alternative sources of credit with greater ease. FGS would like to encourage a review of the lending regulations for existing and new entrants. As a small business, today a financial institution leverages outdated credit risk data that mostly relies on forward looking business estimates. Businesses are denied loans and are left to self-fund or find access to capital at higher interest rates. This is absolutely uncompetitive and based on outdated views of managing risk. If the benefits of open banking were fully realized, it could lead to the growth of small businesses and the creation of new jobs and increased employment in Canada.

FinTechs have great potential to thrive in the open banking era as they would have guaranteed and formal access to data to feed their algorithms to better predict the cost of financial products and services based on a customer's transactional data rather than offering an average rate to everyone. For example, WealthTech companies can offer more personalized and better investment options to customers based on open access to and analysis of consumer data.

What FGS is describing is an era where FinTechs, WealthTechs and incumbent big banks will be afforded new avenues to collaborate and create improved products and services and, ultimately, a better customer experience. Financial institutions will need to be convinced of the potential benefits of open banking for their organization, and that they will not become the losing entity in this new system. Financial institutions need to recognize that FinTechs and other third parties are gaining access to consumer data already, for example, personal finance management apps. Financial institutions would benefit by being proactively engaged influencers in shaping open banking regulation that provides equal protection for their organization and their customers.

With open banking, financial institutions would have an opportunity to leverage innovative technologies to offer better and more tailored products to their customers, which would be a determining factor in customer retention and lead to new revenue streams. Financial institutions would be wise to capitalize on open banking by enhancing their products and services through innovative partnerships with FinTechs or building in-house. Open banking APIs could also add value to a financial institution's existing data analytics as they would be able to access customer data from other financial institutions. This data transparency and sharing should enable financial institutions to anticipate customer needs and offer products and services aligned to those needs leading to higher customer engagement and retention. Open banking could also help

financial institutions convert and attract customers from other banks that are not offering more personalized products and services. Financial institutions should be developing their open banking strategy quickly and determining the strongest benefits to them in order to maintain mutually beneficial relationships with their customers in a data-driven economy.

Simply making data available is not enough to increase competition and access to improved financial services - financial institutions would need to change other policies. For example, availability of transaction data will not result in a person being approved for a loan if the person has a poor credit score and the financial institution uses traditional credit scores for underwriting. Financial institutions would need to adapt and change their underwriting policies in order to adjudicate based on alternative data points. It needs to be stressed that open banking is only one factor, and the open availability of data by itself will not lead to lower rates. For example, alternative lenders access their capital for lending from a wholesale market at a much higher rate as compared to what banks pay on deposits. The lending rates of alternative lenders cannot compete with the rates from financial institutions, which does not result in an increase in competition in the lending space. We need to be aware that for open banking to truly increase competition and benefit consumers, it involves much more than access to data.

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?

It is the view of FGS that in order for Canadians to feel confident in an open banking system, regulations should be governed at the federal level. General Data Protection Regulations (GDPR) in Europe has defined strict measures regarding the handling of data, but issues occur when there is a lack of oversight. The biggest area of concern is the enforcement of regulations. Hefty fines and severe punishment have proven insufficient in deterring violations. Preventative measures are necessary in establishing a viable framework, and penalties must be prohibitively structured so that violations are not just viewed as a cost of doing business. The success of open banking depends heavily on public confidence that data is protected by the highest standards. The rights of the consumer should take priority when drafting open banking regulations or legislation.

Protection of consumer rights and privacy must be strict and transparent. Important considerations include, but are not limited to: access to data, ease of access, withdrawal of consent, right to deletion, and timely reporting of data breaches. Accessibility should also be kept in mind for non-adopters of open banking. The

majority of consumers are unaware of the value of their data, what is being collected, what it is being used for, and by who. Transparency should span across all aspects of data. Consumers have a right to know how they are impacted in this data-driven world, in plain language. Canadians need to be educated on open banking, and it is up to the those who regulate open banking to demystify how data will be governed in the new system.

Identity verification and authentication are also important to instilling confidence in open banking. However, developing any federal mechanisms could stifle meaningful progress towards open banking. Global institutions are already handling Canadian data. Legislation should clearly define how non-Canadian entities use Canadian data. Financial institutions have done a great job in responding to and protecting Canadians from fraud, so they should be given dispensations by the government in case of fraudulent activity in order to ensure that the entire liability is not left on them.

Financial stability currently relies on the capital of financial institutions and guarantees made by the government. The Canadian Deposit Insurance Corporation (CDIC) provides insurance on deposit balances of up to \$100,000 for member institutions. These types of government services should also be accessible to FinTechs, albeit under careful selection. Regulations should include guidelines and limitations for services of varying financial sizes. Deposit accounts of different amounts, money transfers, and any other

financial service offerings should have different requirements based on their risk assessments.

Open banking regulations are not necessary to implement open banking as these types of products and services are already offered in Canada. The importance of legislation is to be able to enforce regulations and protect each stakeholder participating in the open banking system.

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?

FGS is of the view that Canada should move forward with implementing an open banking system since transactional data sharing is already happening in the industry. We believe it is best to formalize and regulate open banking to protect Canadians. The Department of Finance has taken an important first step into the possibility of an open banking system in Canada by starting a dialogue and soliciting input from the stakeholder community.

We strongly believe that an open banking framework and the associated legislation should be enforced solely by the federal government and there should

not be different regulations for separate provinces. Also, the framework needs to be ‘one size fits all’, so the same regulation applies to all stakeholders in the open banking ecosystem.

The federal government should develop a holistic open banking governance framework and appoint an objective third-party committee that will be responsible for overseeing the implementation and proper functioning of an open banking system in Canada. This third-party should not profit from open banking and its members should not be comprised of financial institutions. The control over data needs to rest with the consumer or entity who generated it, and the governing body of open banking cannot exploit the system for its own gain and ability to control access to data. The areas of focus of this third-party entity should include:

- Setting specifications for open banking APIs
- Setting messaging and disclosure standards
- Setting data security standards
- Maintaining the directory of institutions enrolled with open banking
- Defining the procedure for handling complaints and disputes

The federal government should take steps to educate Canadians on what open banking means and how it impacts them. Open banking is not a common concept for Canadians and represents a significant change in the way we bank today.

A change management approach could be leveraged to create awareness and understanding for all stakeholders and ease the transition to an open banking system.

The core financial sector policy objectives of efficiency, utility and stability will be made much more achievable through an open and competitive banking system in Canada. Alternatively, the combination of the oligopoly in Canada, the regulatory restrictions in payments, lending and new bank licencing, as well as the burgeoning small business market growing at a pace never seen before, will leave Canada in a more vulnerable position against foreign global entrants. We hope that innovation of the speed of our regulatory review process can be achieved so these important changes can happen in short order.

FGS believes that the Department of Finance has taken a prudent and democratic approach to exploring the potential of an open banking system in Canada. We understand that more in-depth discussion between the federal government and stakeholders is required, which is why FGS will be attending the Open Banking Roundtable in Toronto on February 19 2019. We look forward to this opportunity to further share our views on open banking and hear the views of other stakeholders.

**Thank you for the opportunity
to share our views through this
consultation process.**



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