



Sandra J. Stuart
President and Chief Executive Officer

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VIA EMAIL

The Advisory Committee to the
Open Banking Review / Financial Institutions Division
The Financial Sector Policy Branch
Department of Finance, Canada
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To the Members of the Advisory Committee:

Thank you for the opportunity to comment on the Department of Finance's Consultation Paper reviewing the merits of open banking. As you know, HSBC Bank is one of the world's largest banks with operations in almost 70 countries and has been active participant in the open banking discussions of many of these jurisdictions. Given our experience in both Canada and internationally, we have a unique perspective on a number of the proposed elements of a Canadian open banking regime.

In line with your invitation for comments, we are providing responses to the three broad questions raised in the Consultation Paper. We also wanted to confirm that we have no difficulty with you making the entirety of our comments publicly available.

What are the potential benefits that an open banking regime could provide Canadians?

The 2018 Budget provides the following useful definition of open banking:

"At its core, open banking is about empowering consumers to share their financial data between their financial institution and other third party providers through secure data-sharing platforms. In turn, this enables financial service providers to offer more tailored products and services on a more competitive and innovative basis. Open banking also has the potential to provide consumers with greater transparency on the products and services offered by financial institutions, thus allowing them to make more informed decisions. It is also able to make it easier for consumers to move and manage their money."

In principle, we agree that open banking clearly offers the potential for significant benefits to Canadian banking customers. However, in our view, the actual benefits that would flow from a Canadian open banking regime are best demonstrated by asking the question, "What would a Canadian banking customer be able to do under an open banking regime that they are not currently able to do?"

In large part, the answer will depend on the types of financial data that customers are empowered to share and what they can consent to permit banks and third party providers (TPPs) to do with this data. The Consultation Paper suggests that customers would be able to share financial transactions data relating to withdrawals and account balances associated with their banking, credit card and investment activities (pages 3 and 5).

It is our hope that this is only an “indicative” list and that, in practice, a customer would be able to share all of the financial data (e.g. mortgage and other data) associated with their everyday banking activities. In our view, the larger the pool of available customer data, the greater will be the potential benefits that consumers can derive from an open banking regime.

As for the activities that customers should be able to allow banks and TPPs to undertake on their behalf, the Consultation Paper asks whether these should ultimately be extended to include “payments initiation” (page 6). On this point, we would note that all other open banking regimes (with the exception of Australia where open banking is part of the country’s larger open data initiative) include payments initiation and that, as confirmed by our international HSBC colleagues, these jurisdictions see payments initiation as the area that provides the greatest benefit for banking customers.¹

On the related question of how payments initiation should be “appropriately staged and aligned with payments modernization”, we would note that other jurisdictions have shown that rather than preceding open banking, there are advantages in open banking preceding payments modernization. The argument being that one of the preconditions for an effective open banking regime (as noted in the Budget definition) is a “secure, data-sharing platform”, which provides banks and third party providers with strong assurances that the customer data that they share will be protected. In practice, this has meant the establishment (and widespread adoption) of a secure open Application Programming Interface (API) banking standard.

In this regard, the UK experience is instructive. Following the launch of its Faster Payments System in 2008, fraudulent activities associated with online banking rose almost 300 percent. This was combatted not only by stronger authentication procedures, but also by efforts to reduce traditional screen scraping by strongly encouraging the move to open API banking standards.² In the Canadian case, we would argue that the move to open banking and the associated move to an open API banking standards would appear to have significant advantages in reducing the opportunities for fraud associated with payments modernization.

How should the risks related to open banking be managed?

We will focus our comments on the risks associated with consumer protection and financial stability. In the area of consumer protection, the ability to provide banking customers with strong assurances that their financial data is safe and secure will be critical to the success of Canada’s open banking regime. Given that the fundamental feature of open banking is the ability of banking customers to share their data with TPPs, a key question is “how can the regime best ensure that certain of these TPPs are not “bad apples” that will make inappropriate use this information?”

¹We also believe that as an open banking regime without payments initiation would provide customers with fewer benefits, customers would find such a regime less attractive and consequently make less use of it. As an aside, we would also note that in reviewing the benefits of open banking (pages 9 to 11), the Consultation Paper provides no discussion of the benefits arising from payments initiation.

²In fact, with the widespread adoption of open API banking standards, EU authorities are now in the process of banning the use of traditional screen scraping.

The short answer is that it will be essential that all of these TPPs are rigorously vetted which, in turn, raises the question “what is the most effective approach to vet these entities?” Broadly speaking, there are two different approaches that can be considered -- a UK-style regulatory-led approach and a US-style, market-driven approach.

In our view, a UK-style mandatory approach fits the Canadian situation significantly better than a US-style voluntary approach. Under a UK-style approach, a TPP that wants entry into the open banking network would need to meet a uniform set of rigorous authorization requirements. (In the UK case, these include minimum security, governance and insurance standards.) The Government would work collaboratively with the banks and TPPs to negotiate these requirements and then be responsible for rigorously enforcing adherence to them.³

In practice, this would mean that if a customer were to ask their bank to share their data with an accredited TPP, the bank would be required to do so.⁴ In contrast, under a US-style approach, the banks would be responsible for undertaking their own due diligence (in line with their various risk appetites) and then establishing contractual agreements with each of those TPPs with which they feel comfortable sharing their customers’ data. Unlike the UK situation, this means that there would be no legal requirement mandating a US bank to share its customer’s data with any particular TPP.

In considering the differences between these approaches, we would highlight the following three points:

- The UK approach provides the government with control of decisions in areas such as the launch date of the regime, the identification of participating banks and the authorization requirements of TPPs. In contrast, the US approach leaves these decisions in the hands of individual banks, which has led to significantly slower progress in the adoption of open banking in the United States and more limited customer engagement;
- The UK approach would appear to reduce the risk of internal inconsistencies. To take an example, a US customer seeking to share their banking information with a TPP could find that one of their US banks has signed a contractual agreement with that TPP, while their second bank has not. As such, the expected benefits of open banking would be reduced; and
- There would appear to be a risk that the US reliance on contractual agreements could potentially inhibit the longer-term growth of the fintech sector. The argument being that the need for a fintech to negotiate individual contractual arrangements with each of the banks whose customers it wishes to deal with, would be extremely cumbersome and difficult to implement.⁵

³ To date, the United Kingdom has accredited more than 60 TPPs.

⁴ That said, a UK bank is able to block a TPP’s access to its customer’s banking data in the event that it suspects fraud or unauthorized access.

⁵ It has also been noted that the longer-term growth of the fintech sector would be additionally complicated if banks were to subsequently decide to terminate these contracts. On this point, in its recent “Report on Nonbank Financials, Fintechs and Innovation”, the US Treasury notes that it has not been uncommon for fintechs to find their API access “frequently and unilaterally restricted, interrupted or terminated by financial service companies”.

In terms of the possible increase in prudential risks associated with open banking, we would concede that the move to an open banking regime, which would allow customers to more easily switch their accounts between financial institutions, could conceivably create additional liquidity risks for certain (uncompetitive) financial institutions. As such, this may result in some small increase in micro-prudential risk. However, we are hard pressed to see any scenario in which open banking would be linked to larger macro-prudential risks (e.g. would be linked to large-scale financial disintermediation) and raise significant concerns about the stability of the broader financial system. Nevertheless, we would agree that situation should continue to be monitored.

What role should the Government play in implementing a Canadian open banking regime?

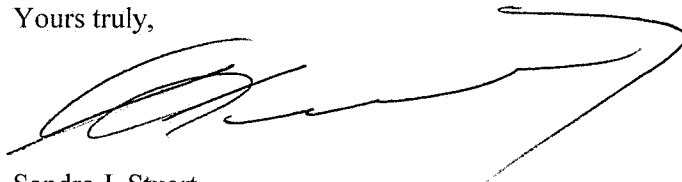
Broadly speaking, we believe that it is important that the Government be strongly engaged, and work collaboratively with the banking community, in the design and implementation of a Canadian open banking regime. In particular, it appears that the Government has a critical role to play in the following areas:

- **Types of Financial Data** – As noted above, we see value in allowing banking customers to share all of the types of data associated with their everyday financial transactions that they wish to share. This is consistent with the view that a Canadian open banking regime would benefit from the largest possible pool of data;
- **Reciprocity** – As noted above, while we see the benefits of creating the largest possible pool of data, we would have reservations about the requirement of “mandatory reciprocity”. Just as a customer should be required to consent to have their banking data shared with a TPP, we believe that the customer should also be required to consent (or “opt in”) to have the data held by their TPP reciprocally shared with their bank;
- **Access Rights** – As noted above, we see significant advantages in not only allowing financial institutions and TPPs to have access to “read” banking customers’ data, but also to have the ability to “write” and initiate payments. To date, the open banking regimes in almost all other jurisdictions provide both “read and write” access;
- **Participating Financial Institutions** – As in the United Kingdom, we see value in the Government requiring all of the major Canadian banks to participate in open banking. We also see value in an “inclusive” regime that allows the participation of smaller “challenger” banks that are able to meet all of the technological and other requirements;
- **Other Entities** – The Consultation Paper primarily focuses on the merits of open banking involving federally-regulated financial institutions (FRFIs) and TPPs. We believe that additional discussions are needed if this regime were also to be extended to non-FRFIs, foreign financial institutions, foreign TPPs or large technology companies (e.g. the GAFAs);
- **Third Party Authentication** – We believe the Government should establish a uniform set of rigorous authorization requirements for any TPPs that wish to participate in the open banking network. As noted above, these should include minimum security, governance and insurance standards;

- Liability and Redress Mechanisms – We believe that the locus of liability associated with open banking needs to be clearly articulated and well understood. The requirement that all accredited TPPs have appropriate professional indemnity or comparable insurance should be a critical element of this discussion;
- Standards-Based Technology – We believe that the necessary precondition for a successful open banking system is agreement on the introduction of a common open API banking standard. The Government has a key role to play in working with the private sector to establish this standard and set a date by which time it needs to be in place. In addition, there would be significant advantages if this standard were interoperable with standards established in other jurisdictions.⁶
- Timelines – With clear understandings of the above areas in place, we believe it is critical that the Government bring forward legislation that sets a formal date for a Canadian open banking regime to come into force. As part of the discussions surrounding this legislation, the Government will need to decide whether it intends to pursue a “big bang” approach or whether certain elements of the new regime will be introduced in stages.

We hope that these comments have been helpful and would be pleased to provide any additional information that you might need. As indicated above, we believe a well-designed open banking regime could provide Canadian consumers and the broader economy with significant benefits. Thanking you in advance for your consideration.

Yours truly,

A handwritten signature in black ink, appearing to read 'Sandra J. Stuart', with a long, sweeping horizontal stroke extending to the right.

Sandra J. Stuart
President & CEO

⁶ It is worth noting that while the European Union's PSD2 permits the establishment of a number of open API banking standards, the United Kingdom has seen strategic value in working with banks and other stakeholders to establish a single open API standard.