

VIA ELECTRONIC SUBMISSION

February 11, 2019

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
Email: fin.Obbo.fin@canada.ca



Dear Advisory Committee,

Luge Capital appreciates the opportunity to respond to the request for comment on the Department of Finance consultation paper *“A Review into the Merits of Open Banking”* seeking the views of Canadians on the potential benefits and risks of an open banking system, to be shared with the Advisory Committee on Open Banking.

Luge Capital is a Canadian venture capital fund focused on investing in early-stage fintech companies and artificial intelligence solutions applied to financial services. The \$75 million fund began operations in April 2018 and is backed by leading Canadian financial institutions including the Caisse de dépôt et placement du Québec (CDPQ), Desjardins Group, Sun Life Financial, La Capitale, and Fonds de solidarité FTQ, which collectively provide financial services directly and indirectly to Canadians across the country.

The fund supports the development of innovative solutions that improve customer experiences, enhance efficiency for financial institutions and implement data-driven methods and artificial intelligence for decision-making. Luge Capital specializes in the financing of emerging fintech companies, with initial investments between \$150,000 and \$2,000,000.

The Department of Finance has invited comments on the consultation paper regarding several important questions related to open banking. This submission provides Luge Capital’s responses to those questions. As requested, Luge Capital provides consent for the Department of Finance to indicate that these comments were received from Luge Capital and for all or any portion of this comment letter to be made public. We would be pleased to discuss these comments further at the convenience of the Department of Finance or the Advisory Committee on Open Banking.

Sincerely,

A handwritten signature in black ink that reads "Karim Gillani".

Karim Gillani
General Partner
Luge Capital
Toronto and Montreal, Canada

A handwritten signature in black ink that reads "Ramin Wright".

Ramin Wright
Investment Analyst
Luge Capital
Toronto and Montreal, Canada

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

As a fintech-focused venture capital fund, Luge Capital is regularly exposed to the potential benefits that open banking would provide to the financial services industry. By empowering Canadians with control of their personal financial data, open banking would enable innovation in the marketplace.

1.1 – Innovation in multiple financial services verticals

Consider a Canadian applying for a personal or business loan, a rather common occurrence in today's economy. Under an open banking structure, that person would be able to provide lenders a more complete view of her financial history, allowing for a credit score that is holistic and dynamic, incorporating real-time data that traditional credit scores do not. Application forms and other ancillary documents requiring the input of personal financial data such as employment history, current assets and liabilities can be completed automatically with the individual's consent. The entire application process could be completed quickly and efficiently simply by enabling the consumer to give consent for her banking information to be shared securely with a third party lender. The result is the potential to extend credit to financially-healthy individuals who would otherwise have been turned down based on a traditional credit score. Furthermore, the increased efficiency in the application process would drive increased competition amongst multiple lenders, providing consumers with more choice and an opportunity to obtain better terms and a better rate.

The improvement available to Canadians in lending, brought about by an open banking system, is mirrored in multiple areas in which Canadians interact with the financial system. A few examples here illustrate the value Canadians would receive from the ability to control and make use of their own financial data:

1. **Insurance**: By providing insurance carriers or brokers access to their financial data, open banking would enable Canadians to receive more customized, and even proactive insurance policies. For example, a Canadian applying for life insurance could be presented with a highly personalized policy based on current and trending income levels, along with anticipated expenses based on other Canadians who have demonstrated similar spending patterns. Over time, the policy could be adjusted as the consumer experiences life events (marriage, children) and shifts his spending habits, or has fluctuations to income.
2. **Wealth Management**: An open banking system would give Canadians more control over their finances and could offer a more personalized experience managing their wealth. Consider a young Canadian that wants to save for retirement. By consenting to provide a digital wealth management service with access to her financial data, she could receive investment suggestions that adapt dynamically with income, spending habits, risk tolerance, other investments (such as real estate) and future financial needs. Banking history data could be tracked over time to better suggest monthly investment amounts, savings goals and types of investments.

3. **Banking**: By providing Canadians with control over their financial information, open banking would enable a consolidated view of an individual's current and historical financial life across all their accounts. An individual with multiple deposit accounts, a mortgage, a student loan, and investments through various institutions would have a consolidated view of their financial life across all these institutions. This is important because consolidation can enable a deeper level of analysis on the financial health and future needs of an individual compared to a view into a single account. Further, open banking would make the process of switching banks or opening an account at a new financial institution seamless because the customer's data would be transferrable by consent. Open banking would provide the infrastructure to enable greater consumer choice for banking services, and an efficient means to switch. Just as mobile telephone number portability increased consumer choice and competition in the telecommunications industry, open banking would pave the way for portability of an individual's finances. This fundamental shift would allow greater banking competition in the form of emerging "challenger banks" and the services surrounding them.

1.2 – Payments initiation as a component of open banking

While the ability to view and share financial data is extremely valuable, an open banking framework that includes the ability for trusted parties to initiate payments would allow for entirely new sources of innovation.

Presently, whenever a payment is initiated by the beneficiary institution (receiving depository financial institution, or RDFI), known as a "pull payment", the ultimate beneficiary must account for the potential of non-sufficient funds (NSF) and repudiation risks. These risks exist in almost all pull payments infrastructure, including the electronic funds transfer (EFT) system in Canada and the automated clearing house (ACH) system in the US. In the future, a robust open banking framework could enable instructions from an RDFI to send payment instructions to an originating depository financial institution (ODFI) in real-time and not only check for sufficient funds but also place a hold on those funds until they are cleared, eliminating NSF risk, and even enabling instant pull payments. In addition, including payments initiation in the Canadian open banking framework could lead to future innovations such as real-time account verification and real-time balance query and transaction posting, abilities that would set Canada as a global leader in payments innovation.

1.3 – New innovation stemming from open banking

In addition to improving the experience of Canadians interacting with financial services, a comprehensive open banking framework could lead to the future development of an entirely new sector surrounding the storage of financial data. Today, financial institutions are the de facto default storage unit for financial data. However, open banking would enable easy portability of financial data, which could give rise to an industry that focuses on the secure storage of such data. These digital "vault" entities could then be instructed by the ultimate data owner to share only specific portions of the dataset with banks and other organizations as the individual desires. If any information is updated in the vault, such as a mailing address or transaction history, then

those institutions who have been granted permission would automatically have access to the latest information, greatly reducing administrative errors.

2. *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?*

The Canadian financial services industry is recognized worldwide for its stability and security, and the implementation of open banking should keep these pillars in mind. While regulation for the benefit of consumer protection, privacy, cyber security, and financial stability should exist, they should be clear, concise, and functional so that emerging fintech companies are set up for success. From a global perspective, Canada's open banking framework should follow the same ISO standards as other countries, such as the UK and Singapore, and could be designed in collaboration with the newly formed Global Financial Innovation Network (GFIN). For example, the ISO 20022 standard provides a unified language for financial communications between international financial institutions and their customers, which could be adapted to accommodate the needs of open banking with the international perspective of the GFIN.

Open banking regulations should follow the core principles of (i) providing clear guidelines that are flexible to grow with emerging business models, (ii) cooperation with the standards required by parallel open banking frameworks in international jurisdictions, and (iii) development in consultation with industry stakeholders such as existing financial institutions and emerging fintech companies. These principles are illustrated below with examples from each of the key focus areas in which comments have been requested.

2.1 – Consumer Protection

Consumer protection is an important area for carefully drafted regulation. While prescriptive rules may achieve short-term goals, long-term growth is enabled by regulation that is cooperative with international jurisdictions. Consider a consumer protection regime that requires financial data of Canadian residents to be stored exclusively in a warehouse that is geographically located within Canada. In connection with similar rules in multiple foreign jurisdictions, it may become cumbersome for an international financial services organization to properly maintain various storage facilities across the globe when dealing with data that belongs to individuals living in and moving between those jurisdictions.

In order for companies to comply with such rules, the Canadian open banking framework should adopt a passport system that allows financial services companies to effect compliance by either (i) complying with the open banking consumer protection laws of approved foreign jurisdictions or (ii) allowing the individual that owns the data to resolve the conflict. Regulation that accounts for the international growth ambitions of Canadian fintech companies will serve to fulfil that growth.

2.2 – Privacy

Privacy concerns are very important when dealing with consumer financial data. However, it is extremely difficult for emerging companies to comply with the existing intersection of privacy laws

across multiple jurisdictions. For example, the privacy laws of Canada and Europe have a global reach but are not entirely congruent. Compliance with either one does not necessarily imply compliance with both, resulting in administrative difficulties that slow growth. Again, Canada's open banking framework should consider allowing a passport system where an emerging fintech company could comply with the Canadian Personal Information Protection and Electronic Documents Act (PIPEDA), the European General Data Protection Regulation, or similar privacy laws in other jurisdictions.

A similar passport system presently exists within PIPEDA, where, generally, compliance with provincial legislation that is "substantially similar" to PIPEDA results in compliance with PIPEDA. We would propose that this rule be expanded to cooperate with international jurisdictions.

2.3 – Cyber Security

Cyber security should be a central focus given the sensitivity of the personal financial information. Facets of cyber security that should be addressed in Canada's open banking framework are the manner in which (i) financial data of Canadians is stored and transmitted and (ii) emerging fintech companies are given access to open banking protocols.

Concerning the former, Canada's open banking framework should follow the same physical and cyber security standards adopted by existing international organizations, such as the Payment Card Industry Data Security Standard (PCI DSS) with respect to payments security and the Service Organization Control (SOC 2) standard with respect to organizational controls related to security, confidentiality, and privacy.

With respect to the latter, the manner in which companies are given and revoked access to open banking protocols should be clear and unambiguous. Whether through a registration system or a certification process, the onboarding of companies into the open banking framework should not require an onerous, costly, or lengthy process.

These regulations should be drafted in consultation with recommendations from industry stakeholders, including financial institutions and emerging fintech companies, and to offer compatibility or a passport system with similar regulations in foreign jurisdictions. While cyber security is of the utmost importance, a requirement for emerging companies to comply with overlapping and possibly conflicting regimes in multiple jurisdictions would serve to hamper the growth of Canadian companies internationally.

2.4 – Financial Stability

Financial stability is a pillar of the Canadian economy that we should strive to maintain. However, care should be taken prior to the imposition of an onerous regulatory scheme surrounding financial stability within Canada's open banking framework. For jurisdictions in which open banking regulations have already been developed, such as Europe and the United Kingdom, it is not evident that open banking has resulted in large-scale disruption of financial stability. We would urge the government to consult with industry stakeholders in the development of regulations concerning financial stability within Canada's open banking framework.

To maintain stability, regulation needs to be fair and appropriate, and not overly lenient for emerging fintech companies such that they are able to jeopardize key elements of the economy. No one company should have the power to significantly damage the stability of the Canadian financial industry, especially the infrastructure we have built carefully and rely on daily. Regulatory limitations may be put in place such that the core of the Canadian financial system is not exposed. For example, emerging fintech companies should not be able to accept and underwrite massive numbers of risky mortgages for uncreditworthy individuals and should not have unfettered access to the Electronic Funds Transfer or Large Value Transfer System payments infrastructure prior to proving themselves as trustworthy market participants.

3. *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?*

Luge is supportive of a hybrid implementation of the Canadian open banking system that is led by the federal government in conjunction with strong guidance by key industry participants and stakeholders such as existing financial institutions and emerging fintech companies. Recommendations for specifics of these roles are presented here.

3.1 – Role of government

In pursuit of a comprehensive open banking framework that provides comprehensive benefits and spurs innovation and competition for all stakeholders, we recommend that the government and industry stakeholders work together in its development. While the government will ultimately set the timeline and draft legislation, the core requirements of how consumer financial data is stored, accessed, and modified should be guided by an industry panel of Canadian financial institutions and fintech companies.

In order for the Canadian open banking framework to be (i) standardized across the country and (ii) collaborative with parallel frameworks in foreign jurisdictions, the federal government should look to the implementation of open banking legislation in other jurisdictions and adopt the elements that are effective, efficient and portable for a Canadian context. Further, Luge recommends that Canada develop a passport system with foreign jurisdictions such that compliance with one regime implies compliance with all regimes that participate in the program. An international passport system would allow financial institutions and fintech companies to effect compliance with Canadian open banking regulations through compliance with the open banking standards surrounding privacy, consumer protection, cyber security, and financial stability in other jurisdictions, such as Europe, the United Kingdom, the United States, and Japan.

As technology develops in the future, business models will change, and the open banking framework should be flexible enough to adapt to those changes nimbly. In order to provide quick and efficient responses to future developments, the open banking framework should be drafted to (i) provide flexibility for future business models and (ii) allow for amendments to be made outside of the parliamentary legislature.

Timeliness is paramount in the development and implementation of Canada's open banking framework. Innovation that relies on open banking is ongoing in multiple foreign jurisdictions, and the Canadian financial services industry should not be left behind in this new green field of opportunity. The federal government should promptly set a timeline that lays out in detail the key milestones and effective dates for the collection of industry stakeholder input on proposed legislation and the effective date of open banking implementation in Canada. If it is not possible to issue a full set of open banking standards in a timely manner, the government should consider a phased approach to allow for innovation as soon as possible.

3.2 – Role of industry stakeholders

A panel of industry stakeholders that includes banks, emerging fintech companies, and other players in the Canadian financial services industry should be responsible for providing recommendations to the government on the core facets of the open banking framework. This would include development of the core capabilities of open banking, technical details of how access to consumer financial data is authorized, and other requirements for how financial institutions and emerging fintech companies should interact within the open banking framework. Industry stakeholders should also provide recommendations surrounding how to build a standardized and open protocol for access to data, such that emerging fintech companies are not required to (i) develop technical integration unique to each financial institution; or (ii) negotiate data access agreements with each financial institution.

With the federal government and industry stakeholders working together, we believe that the Canadian open banking framework will succeed in delivering value to Canadians by allowing them access to and control over their own personal financial data. Canada as a whole will benefit from long-term growth and innovation that is unlocked from open banking.

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