

Intelligence MEMOS



From: Jeremy M. Kronick
To: Canada's Financial Regulators and Policymakers
Date: June 7, 2018
Re: **OPEN BANKING: HERE'S WHY ITS TIME HAS COME**

Senators, insurers and banks are embroiled in a dustup over giving more power to banks to sell customer data to third parties. Even the privacy commissioner weighed in with concerns about the proposed changes to the *Bank Act* in the government's omnibus budget bill.

Unfortunately, lost in the squabbling is the importance of developing a broad strategy for "open banking" in Canada's financial services sector. Determining how to reconcile the benefits of more competition and technology-driven innovation in the use of customer data with concerns over privacy and security will be critical for industry, government and the consumer. An open banking strategy, which will allow customers to authorize the sharing of their financial data from multiple sources with third parties, is an essential foundation for the future.

Within the *Bank Act* portion of the behemoth budget bill is the removal of a requirement that the Minister of Finance approve the engagement of financial institutions in "collecting, manipulating, and transmitting information." Those in opposition argue that banks, without authorization, would then be able to sell our data to unregulated companies, who are more susceptible to cyberattacks that could put Canadians at risk.

The problem for the naysayers is that the sharing of financial data with third parties is coming to Canada, and indeed is already occurring – though in a limited setting largely controlled by the banks. It is coming because sharing data has attractive benefits for consumers. For example, a third-party provider can aggregate customer spending data, sift the information and identify user cost savings.

These types of benefits explain the motivation behind open banking, which was recently introduced in the UK and EU. As a result of these developments abroad, the Canadian government announced in this year's budget that it would review the merits of open banking.

In broad terms, open banking requires large financial institutions – with customer approval – to share banking data between two unaffiliated parties through application programming interfaces. The big idea is that by making it easier for consumers to share their financial data will spur the types of tailored products and services that create a more innovative and competitive financial services sector.

Another nice feature of open banking – and one that should placate those like the insurers concerned over the language in the budget bill – is that third-party providers are regulated and must receive approval from the regulatory authorities.

So what's the big concern? It boils down to privacy and security. Data could end up in the hands of smaller companies that have spent less on data protection than the big banks. That is a fair point, but much has been – and continues to be – done in the world of identification and data storage to weaken this argument.

For example, countries such as Australia, and Estonia, are pioneering digital identification. While the model can vary, one digital identification setup could involve a verified, portable ID, controlled entirely by the individual, with that person choosing which parts of their identity to give out. Access by companies would then be limited to that information, and only within the time window they have granted. Verification and data storage is done through the blockchain making it difficult and costly to hack.

The rise of technological innovation does not always align with customer privacy and security concerns. Compound that with fears about how companies use personal data, and squaring the circle can seem daunting. However, promising advances exist in the form of open banking and digital ID. Given movements on these fronts in other countries, it is time for Canada to join others at the forefront of innovation.

Jeremy M. Kronick is Associate Director of Research at the C.D. Howe Institute.

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Federal budgets are an annual rite of spring in Ottawa, as is the deluge of advice to the Department of Finance. But budget-making is a yearlong process, and the work is now in progress. Accordingly, the C.D. Howe Institute is presenting a series of Intelligence Memos in the next few weeks, outlining recommendations that we hope will help inform the policy decisions that are being made now.

From: Jeremy M. Kronick and Nikki Hui
To: The Honourable Bill Morneau, Minister of Finance
Date: November 13, 2018
Re: **PATH TO OPEN BANKING IN CANADA**

In Budget 2018, the government pledged to study the merits of bringing open banking to Canada. As we pass the mid-way point to the next budget, it is time to ask how Canada stacks up, and what is needed to bring open banking to our shores.

Several countries are already a few steps ahead of Canada in developing a comprehensive open banking strategy. In the EU, the second Payment Services Directives (PSD2) came into effect in early 2018. Similarly, a new directive in the UK called Open Banking came into force last January. These directives require banks across the European Economic Area to open up their payments infrastructure and share their customers' financial information with authorized third-party providers (TPPs). The goal is to increase both the level of competition and the types of innovative products lacking in the sector. With open banking, customers get back more control over their data because they decide what data they share, with whom, and for how long. And, if structured well, customers will make better decisions that optimize both their spending and investment behaviour.

What can Canada learn from the implementation of these directives abroad as it considers open banking at home? What Canada-specific questions need answering?

First, the design of the Application Programming Interfaces (API) must be standardized. API is the digital infrastructure created by incumbent financial institutions that enables data sharing across systems. The standardization of the API specification allows easier and safer access to customers' financial data because TPPs do not have to customize their systems for each individual bank. A lack of such standardization threatens to stifle growth of open banking in the [EU](#).

Second, those standards should both ensure the safety and security of customer data, while avoiding being so complex as to turn off potential users. Unlike the EU, the UK does have a clear set of standards for API design, although the user experience has received [criticism](#). The authorization journey for a consumer is too complex, requiring too many unnecessary steps on a complicated interface that is not user-friendly.

Other questions that require answers in a Canadian context: how to regulate TPPs in a world where they are likely to straddle areas of, among others, banking, payments, and securities? How to share responsibilities across OSFI, Payments Canada, the Bank of Canada, and our flock of provincial securities regulators? In the UK, the Financial Conduct Authority, the regulator for all financial services firms and financial markets, has developed tailored support for TPPs to navigate regulatory requirements, and to test ideas in the regulatory sandbox. Coordinating a similar plan in Canada will be difficult, but likely a necessary step.

The financial services sector plays such a critical role in Canada's economy that a major change like open banking should not be taken lightly. Nor should it be dismissed. There is a lot to learn from implementation abroad. We should not squander this opportunity.

Jeremy M. Kronick is Associate Director, Research and Nikki Hui was a Researcher at the C.D. Howe Institute.

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Who's Afraid of Open Banking?

By Thorsten Koepl and Jeremy Kronick (*Forthcoming op-ed accepted by the Globe and Mail*)

The deadline for consultations on the merits and risks of “Open Banking” just passed. So, we ask: Who’s afraid of “Open Banking”? Consumers? Maybe. The big five banks? Probably. Regulators? Definitely.

If one steps back and looks at the Canadian financial services sector, there are certainly reasons to [pursue](#) “open banking”, where new service providers can access customer data from the financial industry to offer more competitive and more innovative financial products. However, before charging ahead with open banking, there are (at least) three questions that must be asked and answered:

(i) Who should own the data?

(ii) How can we make sure the benefits of open banking reach consumers?

(iii) And how can regulators protect both the privacy of personal data and the stability of our financial system?

When people today make transactions or undertake financial decisions, lots of data are generated within payments systems and internal records of financial institutions. The status quo in Canada squarely puts banks as the owners of such data.

This puts your bank in an enviable position. First, data ownership creates a massive advantage as it provides critical customer information for product offerings. Consequently, banks can profit directly from exclusively using this data to charge consumer-specific prices, or from selling the data to interested third parties.

Open banking would presumably change this dynamic. It would put consumers back into a position where they decide who and when a provider can access their financial data from any institution that has collected them.

Once consumers regain ownership of their data, they themselves can profit provided markets develop that function well enough for “selling” this information. Unfortunately, this is not a slam dunk. One cannot price information upfront, so consumers need to rely on market forces to pass on any benefits from sharing their data.

This likely will depend on how data sharing is implemented in the economy. Traditional intermediaries are unlikely to lose significant market share as they still generate the bulk of data. They may offer more competitive pricing, may compete with new products or buy out new providers in the medium term. And customer-oriented pricing may not always benefit all consumers all the time.

But these concerns are less of an issue once consumers really own their data and can freely decide how their data is being used by financial institutions. The bigger issue is ensuring that privacy is protected when data are shared and that open banking does not create regulatory loopholes or sources for financial instability.

Secure data standards, rules for appropriate data stewardship, and a robust approval process for third

party providers accessing data are part of current open banking discussions. However, a universal, digital ID system that improves safety and privacy of data is still missing in Canada, and so is a clear legal framework that would hold financial service providers responsible for inappropriate use of data without explicit consent by their customers.

But even with appropriate safeguards for privacy in place, there remains the challenge of open banking compromising financial stability. In Canada, financial services are not regulated by a single authority and regulation is fragmented between provincial and federal agencies. This makes any approach to open banking – especially one that includes moving beyond traditional banking to insurance, securities, etc. – extremely difficult. It will likely require the Government go in stages, starting with third party providers that are clearly in the “banking” space, which is federally regulated by OSFI. And it will force the Government to work with the provinces to consolidate Canada’s regulatory landscape before taking any further steps.

The consultation document is right to start with the question of merits and risks. If the discussion about open banking achieves nothing else than putting people back in charge of their data – possibly even beyond financial services -- lots will have been achieved. If it also leads to a more streamlined regulatory framework in Canada all the better. Open banking has the chance to set the stage for a more balanced financial services sector; one that recognizes the importance of both competition and stability. And, the hope here is that more competitive financial services will ultimately benefit consumers.

Thorsten Koepl is Scholar in Financial Services and Monetary Policy, C.D. Howe Institute and Professor and RBC Fellow, Queen's University. Jeremy Kronick is Associate Director, Research at the C.D. Howe Institute