TFSA | TORONTO FINANCIAL SERVICES ALLIANCE

September 29, 2017

Director
Financial Institutions Division
Financial Sector Policy Branch
Department of Finance Canada
James Michael Flaherty Building
90 Elgin Street
Ottawa ON K1A 0G5

Dear Madam/Sir,

On behalf of the Toronto Financial Services Alliance (TFSA), I would like to thank you for the opportunity to provide the attached comments regarding the consultation paper on the second stage of the renewal of Canada's federal financial institutions statutes.

As noted in the consultation paper, the Government has outlined its focus on an agenda to build long-term, inclusive economic growth to support Canadians and a well-functioning financial sector is core to delivering on this commitment.

The consultation paper also noted that the financial sector is entering a new period of innovation which needs to be supported and encouraged by government policy and thus much of the comments below are focused on recommendations to strengthen the ecosystem for financial technology. Many of the comments and recommendations below are supported by a recent report released by the TFSA titled *Seizing the Opportunity: Building the Toronto Region into a Global Fintech Leader.*

Please do not hesitate to contact me should you have any questions.

Sincerely,

Janet Ecker
President & CEO
Toronto Financial Services Alliance (TFSA)

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Improving Regulatory Transparency and Coordination

TFSA concurs with the paper's observation that fintechs have identified greater coordination between federal, provincial, and territorial authorities as a means to advance innovation in financial services. TFSA also welcomes the commitment noted in the paper that the Government and federal regulatory agencies are committed to working with provincial and territorial regulatory authorities to better coordinate and share information, and to provide fintechs with more detailed information such as better regulatory contact information.

While the above commitments to improve federal regulatory transparency are welcome the Government should take further specific measures to help the fintech ecosystem grow and succeed. TFSA's recent report on financial technology noted that:

> *"Here in Canada, the current regulatory framework in financial services, as it applies to technology, is widely viewed by fintechs as antiquated, cumbersome and a significant impediment to innovation and growth. Navigating the regulatory maze can be expensive and time consuming for fintech start-ups. Many fintech start-ups have difficulty even in determining which legislation applies to their activities and which regulators have jurisdiction over them."* [1]

The technologically savvy innovators who typically staff fintech start-ups often lack the legal sophistication to navigate a regulatory landscape which includes a myriad of potentially applicable regulations relating to areas such as privacy, securities, consumer protection, and proceeds of crime.

The lack of a single point of entry or source of regulatory guidance has a number of adverse consequences for new entrants and thus should be addressed by governments and regulators. Regulators should commit to working collaboratively with each other in assessing fintech solutions in order to reduce duplication and facilitate the timely delivery of innovative services across provincial borders and across sectors.

One solution to the issue of regulatory fragmentation would be to establish a "regulatory concierge" service to help fintechs navigate the regulatory maze. A regulatory concierge service could provide guidance across a wide range of subject areas and would have a particular expertise in fintech business models and technology and broad access to a wide spectrum of legislation, regulation and regulators. A regulatory concierge service could provide all fintech companies, whether working independently or in collaboration with an existing financial services provider, with a single source of contact through which to engage all relevant regulators in Canada. It could not only act as a gateway but could be tasked with actively helping fintech companies engage with federal and provincial regulators.

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[1] Seizing the Opportunity: Building the Toronto Region into a Global Fintech Leader. Toronto Financial Services Alliance/Accenture/McMillan. 2017. pg. 5.

Creating a regulatory concierge service would require significant collaboration and cooperation between federal and provincial regulators and could be housed within the Office of the Superintendent of Financial Institutions (OSFI), or the Department of Innovation, Science and Economic Development Canada, or the Bank of Canada. A regulatory concierge service could also serve as a national "fintech champion" to help promote and grow the sector and could serve as the centerpiece for a broader fintech innovation hub that could include partnerships with private incubators and academic institutions.

Examples of the federal and Ontario regulators and agencies that could participate in a regulatory concierge service could include:

- Office of the Superintendent of Financial Institutions (OSFI),
- Financial Transactions and Reports Analysis Centre of Canada (FINTRAC),
- Financial Consumer Agency of Canada,
- Competition Bureau,
- Capital Markets Regulatory Authority,
- Payments Canada,
- Bank of Canada,
- Office of the Privacy Commissioner of Canada,
- Ontario Securities Commission (OSC)/OSC LaunchPad,
- Canadian Securities Administrators (CSA),
- Financial Services Commission of Ontario/Financial Services Regulatory Authority,
- Ministry of Consumer and Government Services, and
- Information and Privacy Commissioner of Ontario

Clarifying the Fintech Business Powers of Financial Institutions

Federally regulated financial institutions should be given greater flexibility to provide fintech services that may not fall squarely within traditional categories. For example, currently a bank needs to ensure that any fintech activity it wishes to engage in fits squarely within one of the permitted business activities that can be conducted by a bank under the *Bank Act*. However, in some cases, the permitted business powers set out in the *Bank Act* may not reflect the way that banks could be leveraging technology to provide the new types of services that consumers expect.

To ensure that financial institutions such as banks can lead in financial innovation and continue to deliver enhanced services, the Bank Act should be updated to further encourage financial sector evolution. This should include broadening the scope of activities that a bank may engage in under the Bank Act and adopting a broad and liberal interpretation of these provisions, including broadly interpreting what is a financial service and what is the business of banking.

Facilitating Fintech Collaboration

As noted in the paper, collaboration between firms with different capabilities drives innovation. Collaboration between fintechs and incumbent financial institutions help bring technology and speed to market, and deliver scale through existing customer relationships and balance sheets.

A barrier to collaboration with fintechs involve regulations that stipulate that federally regulated financial institutions are subject to strict limits on making "substantial investments" in entities other than "permitted entities" in specified lines of business without regulatory approval. However, in some cases, the activities of a fintech entity do not fit within the ambit of the permitted entity categories, therefore restricting a financial institution such as a bank from making a much needed strategic investment. Also, in other jurisdictions, banks have extensive referral and networking powers resulting in customers reaping tangible and intangible benefits. In Canada, banks should have greater latitude to refer and network customers for non-financial services particularly as lines blur between financial and non-financial services and products. Customers would therefore benefit from having greater access to innovative products and services and banks would be galvanized to collaborate more with emerging fintech and other companies in delivering services to their clients.

There are also other legislative barriers that could be reformed to encourage greater collaboration and partnerships. For example, insurers cannot hold more than 25% total equity in a corporation or limited partnership, nor can insurers own more than 10% voting interest in a corporation. Allowing flexibility for prescribed investments in fintech, while allowing the commercial links restrictions to remain in place more generally, would allow the insurance industry to make greater investments in fintech thereby helping to drive benefits to consumers in Canada.

Other Regulatory Issues for Fintech

Regulatory Innovation

Other jurisdictions such as the UK, Australia, Singapore, and Hong Kong are implementing or consulting on the concept of a "regulatory sandbox" for fintech. A regulatory sandbox is "a safe space in which businesses can test innovative products, services, business models and delivery mechanisms without immediately incurring all the normal regulatory consequences of pilot activities." While the primary purpose of a sandbox is to support product innovation for the betterment of the consumer, it also has the benefit of promoting competition, attracting top talent and generating revenue for the economy. A sandbox is meant to lower costs and time for market entry and reduce risk by reducing regulatory uncertainty.

The TFSA welcomes the announcement by the Ontario Securities Commission (OSC) of a "LaunchPad" which is meant to provide tailored support to fintech businesses and help them navigate Ontario's securities regulations. This initiative is a positive, first step in the right direction and other Canadian financial sector regulators should look to implement similar mechanisms.

Regulation Focused on Activity

Canada's fintech policy and regulation must continue to carefully balance the interests of innovation, competition, and consumer protection. To achieve this balance, the regulatory framework for financial services, including services offered by fintech companies, should apply based on the nature of the product or service being provided rather than the nature of the entity delivering the product or service. Regulation should ideally focus on activity rather than the entity that conducts it, bearing in mind that "competitive balance" may require that regulation differentiate between large and small players, adjusting for market power, size and structure. Canadian consumers would benefit from a regulatory framework which ensures that participants in the financial system, including fintechs, meet standards appropriate to the financial services activities they engage in and the level of risk they pose.

Technology-Neutral Rules

The legislative and regulatory framework for the financial sector should be reformed to be technology-neutral so that it remains relevant as technology and consumer needs continue to evolve. Many regulations affecting fintechs can seem to be drafted on the assumption that onboarding, disclosure and contracting will be accomplished using pen-and-paper, telephone, and even face-to-face personal contact.[2] Many of the regulations that apply to fintechs may not be well-suited to an online environment and that the application of existing regulatory paradigms to new business models can impose unnecessarily burdensome restrictions without appreciably enhancing consumer protection. It is important that regulations can be complied with regardless of whether the regulated activity is conducted using traditional physical paper-based media or in an entirely electronic environment. FINTRAC and the Department of Finance should seek to modernize client identification and authentication requirements to reduce or eliminate the need for face-to-face contact or reference to original documentation and permit the use of technologies such as biometrics and video links for client onboarding.[3]

Examining the Merits of Open Banking

We have recently seen other jurisdictions explore open banking and both the risks and benefits to consumers. Some stakeholders point to potential benefits such as enhanced customer choice, simplified onboarding, reduced duplication in client identification and authentication requirements, and potential assistance to regulators by making verification procedures faster and easier and improving auditing and oversight capabilities.

[2] Ibid. pg. 38.
[3] Ibid. pg. 53.

However, there would also be significant risks that should be studied before the adoption of such a fundamental change to the banking relationship in Canada. The risks posed to consumers, privacy, and the financial system must be carefully assessed and mitigated before any reforms or new policy measures are enacted.

Finally, open banking is still a new concept which is being adopted in many different forms in other jurisdictions and it is too early to evaluate any negative effects and unintended consequences. It will be more prudent to evaluate the merits of open banking after the impact and best practices from other jurisdictions is more fully realized.

Specialized Infrastructure Investment Powers

Federally regulated life and health insurers should have additional investment powers in infrastructure as this would enable them to better match their assets and liabilities and to more actively participate in the financing of infrastructure.

Insurers have traditionally participated in infrastructure through public-private-partnership (P3) projects across Canada through debt financing, and are a key component in Canada's stature as a global P3 hub.

However, on the equity side, there are legislative and regulatory barriers in place that limit the insurance industry's ability to make equity investments in infrastructure. In particular, subsection 493(1) of the Insurance Companies Act precludes insurers from holding more than 25% total equity in a corporation or limited partnership. As well, under that subsection, insurers cannot own more than 10% voting interest in a corporation. Similar or analogous provisions apply in other parts of the Insurance Companies Act.

Relief from these provisions for carefully prequalified investments should be allowed as this would help support the creation of needed infrastructure. Such flexibility has already been provided to life insurers in Europe so a model for how this could be implemented is already available for study. If this relief is not possible, the Government should at a minimum reform the Specialized Financing (Life Companies) Regulations which currently limit the length of time an insurer can hold certain assets to only 13 years.

Recommendations

- The Federal Government should establish a "regulatory concierge" service to help fintechs navigate the federal and provincial regulatory process. Such a service would provide fintechs with a single source of contact through which to engage all relevant financial regulators in Canada.

- Certain restrictions on the investments and powers of federally regulated financial institutions make it difficult for them to partner with fintechs or offer innovative financial services without ministerial approval. As described above, the Federal Government should revise these provisions to provide incumbent financial institutions with greater flexibility in both collaborating with fintech firms or providing fintech services themselves.

- Other jurisdictions such as the UK, Australia, Singapore, and Hong Kong are implementing or consulting on the concept of a "regulatory sandbox" for fintech. Building on the establishment of the OSC LaunchPad, other Canadian financial sector regulators should look to implement similar mechanisms.

- The regulatory framework for financial services, including services offered by fintech companies, should apply based on the nature of the product or service being provided rather than the nature of the entity delivering the product or service.

- The legislative and regulatory framework for the financial sector should be reformed to be technology-neutral so that it remains relevant as technology and consumer needs continue to evolve.

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About TFSA

The Toronto Financial Services Alliance (TFSA) is a unique, public–private partnership dedicated to growing the Toronto region's financial services cluster and building it as a "top ten" global financial services centre. Established in 2001, TFSA is a collaboration involving three levels of government, the financial services industry and academia. Working collaboratively with industry and government, we build international awareness of the advantages offered by the Toronto region and we work with financial services companies from around the world that are exploring business opportunities in Toronto. TFSA leads an integrated strategy focusing on the areas of growth, international reputation, and competitiveness.