

September 29, 2017

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

Re: Second Stage of Consultations on Federal Financial Sector Framework

We are writing on behalf of the 109,000 small- and medium-sized enterprises (SMEs) who are members of the Canadian Federation of Independent Business (CFIB) to provide feedback on the second stage of the federal government's review of the federal financial sector framework.

A strong and competitive small and medium-sized enterprise (SME) sector is critical to a strong and competitive economy. Its direct contribution amounts to approximately half of the Canadian economy. But the SME sector's role goes far beyond its direct contribution to GDP. SMEs employ the majority of Canadians and are a key foundation in all communities throughout Canada. SMEs are also where many of Canada's innovative ideas are born, laying the groundwork for a more productive Canadian economy.

Given the fast pace of change in financial services sector, such as new fintech entrants and new innovative approaches for payments and lending, the role of public policy on financial services is more important than ever to Canada's SME sector. With the right policy framework, the changing financial services landscape has the potential to better meet the financial needs of SMEs. In this respect, we have outlined our comments and recommendations according to the four policy themes in the consultation document:

- Supporting a Competitive and Innovative Sector;
- Improving the Protection of Bank Consumers;
- Modernizing the Framework; and
- Safeguarding a Stable and Resilient Sector.

Supporting a Competitive and Innovative Sector

As new non-traditional players are emerging, the oversight framework should not create barriers to new entrants to the financial services sector, including the payments system. The focus of public policy should be on promoting truly new entrants that offer low-cost solutions and value for money to merchants and consumers, not just adding new costs to the existing system (e.g., Apple Pay and PayPal add costs to the existing credit and debit card fees, electronic payments are more costly than traditional payments by cheque). Options that simply add costs to existing payments options should not be actively promoted.

The oversight framework should focus on creating an enabling environment for new entrants that encourages them to increase low-cost payment options for business-to-business (B2B) transactions which are often ignored by providers of payment services. In particular, options that facilitate the communications of both invoice and payment data should be encouraged.

CFIB welcomes a policy framework that would allow for the flow of new entrants to the financial services sector, thereby enhancing competition and innovation for SMEs. Given the dominant role of the Big 5 banks in the SME market for banking services, this is an important public policy objective. For example, RBC, Scotiabank, TD-CT, BMO and CIBC control close to three-quarters of the SME market on a national level (see Table 1a). The concentration is even more pronounced in some regional markets such as the Atlantic provinces where RBC and Scotiabank hold more than half the SME market share (see Table 1b).

Table 1a:

SME Market Share 2000-2015, Big Banks and Credit unions, (% , based on clients)

	2000	2009	2012	2015	2000-2015 Absolute Change
Royal Bank	21.2	18.3	18.7	18.5	-2.7
Scotiabank	11.2	16.2	17.9	17.9	+6.7
TD Canada Trust*	12.1	15.3	16.0	16.5	+4.4
Bank of Montreal	12.6	10.6	10.1	10.7	-1.9
CIBC	13.3	10.1	9.9	9.8	-3.5
Credit union	8.7	10.6	11.0	11.5	+2.8

Source: SME Bank Market Share. Toronto: CFIB Research. (August 2016)

<http://www.cfib-fcei.ca/english/article/8624-sme-bank-market-share.html>

Table 1b:

SME Market Share Leaders in 2012 and 2015, (% based on clients), by Region

Atlantic				Quebec			
	2012	2015	Change		2012	2015	Change
Scotia	30.7	33.0	2.3	Desjardins	44.4	42.6	-1.8
RBC	21.7	21.3	-0.4	National	16.4	17.4	1.0
BMO	12.1	13.2	1.1	RBC	11.0	12.0	1.0
CIBC	10.5	8.7	-1.8	BMO	7.8	8.7	0.9
Credit union	9.3	8.6	-0.7	Scotia	6.9	5.5	-1.4
TD-CT	9.1	8.3	-0.8	TD-CT	5.5	5.2	-0.3
Caisses populaires	3.2	2.9	-0.3	CIBC	4.3	4.7	0.4
Ontario				Man. & Sask.			
	2012	2015	Change		2012	2015	Change
TD-CT	23.3	24.1	0.8	Credit union	36.7	39.2	2.5
Scotia	21.5	20.5	-1.0	RBC	19.1	18.6	-0.5
RBC	20.9	20.1	-0.8	Scotia	12.8	13.1	0.3
CIBC	11.8	12.0	0.2	TD-CT	10.1	9.0	-1.1
BMO	11.3	11.8	0.5	CIBC	9.1	8.6	-0.5
Credit union	7.0	7.7	0.7	BMO	7.1	7.0	-0.1
HSBC	1.6	1.0	-0.6	Caisses populaires	1.3	1.8	0.5
Alberta				B.C.			
	2012	2015	Change		2012	2015	Change
ATB	19.5	19.7	0.2	Credit union	21.1	23.0	1.9
RBC	15.7	17.7	2.0	RBC	19.9	17.5	-2.4
TD-CT	14.6	13.4	-1.2	Scotia	16.1	16.3	0.2
Scotia	13.5	13.9	0.4	TD-CT	14.5	15.3	0.8
Credit union	12.2	14.4	2.2	CIBC	10.8	10.1	-0.7
BMO	9.7	7.7	-2.0	BMO	9.6	12.1	2.5
CIBC	7.4	7.3	-0.1	HSBC	5.3	4.2	-1.1

Source: SME Bank Market Share. Toronto: CFIB Research. (August 2016)

<http://www.cfib-fcei.ca/english/article/8624-sme-bank-market-share.html>

Cooperatives such as credit unions and Desjardins play a key role in serving the SME sector and must be taken into account in any change in federal policy. In fact, based on the latest CFIB survey results, credit unions received the highest rankings based on the satisfaction levels of their actual SME clients

(see Table 2). The federal legislative changes to allow credit unions to operate across Canada are a welcome step in this direction.

Table 2:

Overall Rankings, All SMEs, 2015

2015	
1	Credit unions
2	ATB Financial
3	Scotiabank
4	CIBC/National Bank (tie)
5	-
6	Royal Bank
7	Bank of Montreal/ TD Canada Trust/ Desjardins (tie)
8	-
9	-
10	HSBC

Source: Battle of the Banks. Toronto: CFIB Research. (August 2016)

<http://www.cfib-fcei.ca/english/article/8817-battle-of-the-banks-credit-unions-among-the-best-for-small-business.html>

Also, the niche players such as foreign banks are not widely used by SMEs. HSBC, for example, effectively pulled out of the small business market in Canada in 2013, thereby removing a banking option to the major banks for some SMEs.

The past few years has seen a greater role of fintech collaboration with the major banks, especially in terms of lending practices to small businesses. This approach has the potential to improve the way banking and other financial services are provided to small businesses. However, steps needs to be taken to ensure the small business borrower is not being treated as a second-rate bank client by being faced with less favourable lending terms as they would otherwise through traditional lending and at reduced levels of customer service. The government therefore must ensure that new online lending

operations (e.g., Kabbage, Thinking Capital, etc.) supplement, not replace, traditional bank lending to SMEs. Also, fees for such online lending must be kept reasonable to ensure value to SME clients.

CFIB also has several points to help clarify the role of fintechs and open banking:

- It should be clarified what constitutes a “fintech” given the rapid speed of new entrants into the financial sector landscape. Small businesses and consumers in general need to be aware of what type of entity they are dealing with, especially when the interactions are mostly online without access to a direct representative of either the fintech or bank (e.g., customer representative).
- Another concern is that fintechs may be providing similar services as federally-regulated banks. At present, fintechs are largely spearheaded by the big banks (through direct partnerships) although they may not be the prime owners of the fintechs. There are also concerns that big banks may buy out these fintechs (through potential future mergers and/or acquisitions) which may further impede competition in the lending space (traditional or online). There needs to be clarity as to what the differences are between a traditional bank and a fintech.
- There needs to be transparency and regulation around the role of all new financial sector entrants such as fintechs. As noted in the consultation paper, fintechs are often smaller firms with fewer resources—essentially a small business start-up. Balancing the appropriate level of regulation based on the function being provided by the fintech without creating a barrier to entry in the form of unnecessary government regulation needs to be top-of-mind with Finance Canada and any other regulators going forward.
- A clear understanding of the term “fintech” is required so clients know their rights. Given the level of electronic fraud in Canada, customers need to be aware of which financial provider they are dealing with and understand how their finances (e.g. banking, investment, financing, etc) and payment transactions will be protected (e.g., similar to CDIC deposit insurance for bank accounts). Without such clarity, lack of trust among Canadian small businesses and consumers will remain an issue.
- Open banking has the potential to save business owners both time and money. Small business owners want to be able to access and control their banking and payment data that fits the needs of their business and their customers. Currently, bank fees are a major concern among SME owners. Also, the security and privacy of banking and payment data needs to be protected.

Though more competition in the financial sector is welcome, there must be transparency around the fees and services offered by both fintechs and major banks using online lending technologies. As such we recommend that the federal government:

- Ensure that these new types of payments and online lending are not designed to only benefit banks and fintech companies but also benefit the clients they are serving including small businesses.

- Closely monitor fintechs and major banks providing online lending to SMEs to ensure that they do not replace traditional lending or charge excessive interest rates. Fees and rates should be kept reasonable as to ensure value for services offered to SME clients.
- Introduce an independent monitoring agency, similar to the Financial Consumer Agency of Canada (FCAC), which would be specific to SMEs. Otherwise, expand the mandate of the FCAC to include SME bank fees and financing issues. This will ensure greater transparency around fees charged. For example, it would ensure banks provide their small business clients with reasons for why their request for financing is declined.
- Ensure that new entrants into the financing market, whether lending or payments, are included in the *Code of Conduct for the Credit and Debit Card Industry* and the *Small Business Banking Code of Conduct*.

Improving the Protection of Bank Consumers

The federal consumer protection framework, which would include the Financial Consumer Agency of Canada (FCAC), helps protect individual Canadians in their dealings with banks and other federal financial sector participants. CFIB believes that this focus should be broadened to include protection for SMEs. There are several ways to ensure there is fair treatment of banks' SME clients:

- As mentioned in the previous section, introduce an independent authority to monitor bank fees for SMEs and to provide advice on bank fees (e.g., similar to the FCAC for individual Canadians) or expand the mandate of the FCAC to include SME bank fees and financing issues (e.g. ensuring banks provide reasons for why a business is declined for financing).
- Ensure banks actively promote alternative sources of financing besides bank financing (e.g. angel investing, crowdfunding, venture capital) as per the Small Business Banking Code of Conduct. Ensure the policy environment is encouraging of alternatives.
- Monitor use of new online SME lending technology at major banks to ensure that they do not displace traditional lending or shift to usurious interest rates.

Modernizing the Framework

Compared to the banks, credit unions have come out on top when it comes to serving the financial needs of small businesses according to CFIB research. In fact, the SME market share of credit unions has more than doubled since 1989, from 5.5% to 11.5% in 2015. In Quebec, caisses populaires, such as Desjardins, held 42.6% of the SME market share in 2015.

Given this significant role of credit union and Desjardins in serving the SME sector, CFIB is concerned that about any limitations on the using the terms "Bank", "Banker" and "Banking". Such a prohibition

would limit these institutions' ability to effectively communicate with their clients and reduce their ability to compete fairly with the big banks. Canada needs more competition in the banking sector—not less.

While we understand that the goal is to ensure that consumer interests are protected as new entrants to the market emerge, we would caution against enforcing such broad-based, stringent regulation. Overly prescriptive regulation such as this limitation on these three words will make it harder for new entrants to gain access to the market, limiting both competition and innovation in the financial sector.

Safeguarding a Stable and Resilient Sector

The financial sector framework must ensure a secure banking and payment system for SMEs and their customers. Key points that should be taken into account include:

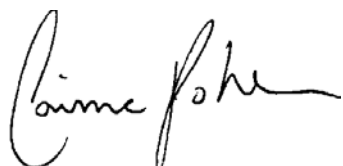
- Facilitate timely financial services, such as payments. Payments for SMEs, and their customers, need to feel assured that payments made and received clear without any problems.
- Protect businesses in cases of system failures by providing backup systems for electronic banking and payments services.
- Reduce the risk of losing sensitive information relating to banking and payments activities. Businesses are concerned with the risk of losing their personal and financial information, as well as their customer data.

The federal government has an opportunity to improve the financial sector framework to foster competition and create innovation among financial service providers serving their SME clients. We thank you for the opportunity to present our views.

If you have any questions or would like to meet to discuss this issue further, please feel free to contact us at our Ottawa office at 613-235-2373 or email Dan Kelly, President and CEO, at dan.kelly@cfib.ca or Corinne Pohlmann, Senior Vice-President, National Affairs and Partnerships at corinne.pohlmann@cfib.ca

Thank you for your attention to this matter.

Sincerely,



Corinne Pohlmann
Senior Vice-President, National Affairs and
Partnerships



Doug Bruce
Vice-President, Research