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Financial Institutions Division  
Financial Sector Policy Branch  
Department of Finance Canada  
James Michael Flaherty Building  
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September 29, 2017

To Whom It May Concern:

**Re: Potential Policy Measures to Support a Strong and Growing Economy:  
Positioning Canada's Financial Sector for the Future (the "Consultation Paper")**

**CONTEXT:**

On August 11th, 2017 the Department of Finance Canada invited the Canadian public to submit its comments for the second stage of its Review of the Federal Financial Sector Framework.

Ferst Capital Partners ("**FCP**") is a Canadian investment firm focused exclusively on Canadian fintech investment and innovation. We provide funding and strategic support for Canadian early stage fintech businesses, we ideate and incubate our own fintech companies, and, finally, through the FCP Fintech Studio, we provide space and mentorship to pre-Seed stage fintech startups to help the fintech startup ecosystem.

Ferst Digital ("**FD**") is an early-stage Montreal-based fintech startup. The company's mission is to empower small business owners across Canada. It is doing so by building a mobile-first tech-forward small business banking platform that helps startups and small businesses bank, manage their finances, and integrate all of their financial products in one place. Ferst Digital is in the process of partnering with a licensed deposit-taking institution so as to offer Canadian small businesses a banking service that is built around their needs.

Both Ferst Capital Partners and Ferst Digital are deeply embedded in the Canadian fintech community and have previously provided submissions and consultations to the Department of Finance Canada, the Fintech interdepartmental committee – Government of Canada, the Federal Competition Bureau, Ministère des Finances de Quebec, and the Canadian Securities Administrators.

As such, both of our organizations are pleased to make this second submission to comment on the Review of the Federal Financial Sector Framework.

Many of the questions posed in the second submission touch on material we presented with our first submission made last year. To this end our second submission will either reiterate or expand on our previous submission. We have attached our first submission for your reference.

## **CONSENT:**

We consent to the disclosure of our comments, without the removal of our identity or personal identifiers, with the exception of the section clearly outlined below.

## **RESPONSE TO QUESTIONS**

### **1. Clarifying the Fintech Business Powers of Financial Institutions**

**Question:** The Department is seeking views on whether to clarify and modernize the type of information and technology activities that federally regulated financial institutions are permitted to undertake in-house, while maintaining the long-standing prohibition on commercial activities. In this context, the Department is seeking views on appropriate statutory language.

**Response:** We encourage the modernization and clarification of any information and technology activities that FRFIs are permitted to undertake in the context of Fintech. Fintech innovation is characterized by the convergence of financial services, technology, and data. This convergence leads to a blurring the lines between commercial activities and financial services. To this end we have begun to see large, data rich technology companies such as the FANGs (Facebook, Amazon, Netflix, and Google) using their access to data, distribution and formidable technology to start offering financial services. While early, we believe it is inevitable they will become formidable providers of financial services. To understand where we are headed, one need to only look toward China's BATs (Baidu, Alibaba, Tencent) who have become dominant financial services providers.<sup>1</sup>

Clarification of information, particularly as relates to customer data, and technology activities permitted is critical in ensuring Canadian FRFIs are able to properly participate in this convergence, and therefore compete, fully in Fintech innovation. Conversely, by not expanding permitted activities, our FRFIs will be at a substantial competitive disadvantage to technology companies who are not limited by the same regulatory constraints. Therefore, while we are not advocating for an end to the prohibition of commercial activities, we encourage a thoughtful review and discussion on what expansion of activities are now appropriate.

### **2. Facilitating Fintech Collaboration**

**Question:** The Department is seeking views on whether to provide federally regulated financial institutions with additional flexibility to make non-controlling investments in Fintech and the corresponding authority to make referrals, subject to appropriate consumer protection, prudential, and commercial activities limitations.

**Response:** We support providing FRFIs with additional flexibility to make non-controlling investments in Fintech and the corresponding authority to make referrals. It is well

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<sup>1</sup> EY – “The Rise of FinTech in China: Redefining Financial Services”, November 2016.  
[http://www.ey.com/Publication/vwLUAssets/ey-the-rise-of-fintech-in-china/\\$FILE/ey-the-rise-of-fintech-in-china.pdf](http://www.ey.com/Publication/vwLUAssets/ey-the-rise-of-fintech-in-china/$FILE/ey-the-rise-of-fintech-in-china.pdf)

acknowledged that incumbent FRFIs struggle to innovate whereas younger, smaller Fintech start-ups struggle to build and scale a viable customer base.<sup>2</sup> The collaboration between both actors is critical to enabling innovation in financial services, providing better products for consumers, and facilitating the ability for Canadian FRFI/Fintechs to compete on the global stage. Anything we can do to encourage collaboration should be considered.

### **3. Improving Regulatory Transparency and Coordination**

**Response:** We support any efforts made to improve regulatory transparency, coordination, and harmonization amongst the patchwork of federal and provincial regulatory bodies. It is our view that the fragmented Canadian regulatory environment is a major impediment to Canadian Fintech innovation.

Canadian Fintech start-up economics are treacherous. With a small market size and the industry dominated by few, large incumbents, start-ups have little time to find product/market fit. A fragmented regulatory environment simply makes it harder. As a result, we are seeing fewer direct-to-consumer Fintechs come to market in Canada, where Fintech adoption rates lag those of other, more progressive, jurisdictions by a large margin.<sup>3</sup> We are also seeing that capital available to fund early stage start-ups in the space is limited because investors, both international as well as Canadian, are telling us they will not fund businesses with any regulatory ambiguity. We understand the sentiment: as investors ourselves, we also do not invest in models with regulatory uncertainty.

Fintech is characterized by the convergence of data, technology and financial services being brought together in new models that blends previously separated, and separately regulated, services. Models can include services, such as personal finance management (“PFM”) tools that, through data, seek to understand its customer’s financial needs and re-aggregate or intermediate all of the customer’s financial products in one place. These types of businesses touch on the whole gamut of financial services: savings, investment, day-to-day banking, borrowing, life insurance, P&C insurance, etc. Under the current regulatory structure in Canada a financial re-aggregator such as described above would be forced to navigate multiple federal and provincial regulators such as OSFI, FINTRAC, FCAC, CDIC, the Office of the Privacy Commissioner of Canada, the Competition Bureau, as well as the separate provincial securities commissions such as OSC or AMF.

If one were to put aside the myriad challenges and inefficiencies of either a start-up or an incumbent navigating the fragmented regulatory environment as exists in Canada, there are also challenges navigating the contradictory and inconsistent regulation that exists between various regulatory organizations. As an example, there are deep inconsistencies between what is required to comply with FINTRAC as opposed to what is considered reasonable by the Federal Privacy Commissioner.

It is our view the emergence of the most innovative and successful Fintech jurisdictions,

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<sup>2</sup> PWC – Global FinTech Report 2017. <https://www.pwc.com/jg/en/publications/pwc-global-fintech-report-17.3.17-final.pdf>

<sup>3</sup> EY – Fintech Adoption Index 2017. [http://www.ey.com/Publication/vwLUAssets/ey-fintech-adoption-index-2017/\\$FILE/ey-fintech-adoption-index-2017.pdf](http://www.ey.com/Publication/vwLUAssets/ey-fintech-adoption-index-2017/$FILE/ey-fintech-adoption-index-2017.pdf)

whereby success is characterized by number of Fintechs created, funded and scaled, as well as high customer adoption rates, is directly correlated with those jurisdictions that get the regulatory piece right. These successful jurisdictions usually have a national regulator that has a global view of all financial services regulation. In the absence of a national regulator, jurisdictions have created a national Fintech Office.

We understand the challenges navigating between our federal and provincial types of government. The quest for a national securities regulator in Canada is a testament to this challenge and we are well aware our inability to solve this problem has been a negative drag on our financial system. We also understand that there are solutions that can be put into place to minimize the damage. The Canadian Securities Administrators (“CSA”) has done an excellent job of coordinating and encouraging consistency between provincial securities commissions and minimizing regulatory overhead. To this end we strongly recommend the creation a national Fintech Office that can rapidly coordinate policy, create regulatory pilots, harmonize regulation, and resolve conflicts between all national and provincial regulators. We believe that in the absence of such an office it is highly likely that Canada will continue to struggle in innovating financial services.

#### **4. Streamlining the Bank Entry and Exit Framework**

**Question:** The Department is seeking views on whether to undertake a series of targeted refinements to streamline and promote a smooth entry and exit process. For example:

- The number of officers a newly incorporated federally regulated financial institution may remunerate could be increased to better meet OSFI's prudential expectations around designated officers; and
- The Superintendent could be provided with the authority to extend the period to issue an Order to Commence and Carry on Business in exceptional circumstances.

#### **Response:**

We support any changes or initiatives that streamlines not only the entry and exit process of banks but also any entity that requires registration or a charter, such as becoming an insurance carrier or securities dealer. Oftentimes, a Fintech requires a registration, charter or designation to fulfill requirements for its business but does not engage in all services under the registration. An example is a Fintech that needs to take customer deposits but does not engage in fractional reserve banking.

We believe the path to a bank charter, or to acquire the ability to engage in bank-like operations is cost prohibitive for start-up economics where cost is not only determined by fees, but also by the length of the process as well as the ambiguity surrounding the final outcome. The manner in which technology start-ups are created where product/market fit is explored through a minimal viable product (“MVP”) cannot work under the current licencing regime. Unless this process becomes flexible or streamlined we will see limited innovation in Canadian financial services.

In other jurisdictions where the regulation is more flexible we are seeing an explosion of innovation (e.g., start-up banks in the UK). They are innovating and developing compelling

new models while in Canada we are not. Eventually, those companies will come to Canada and Canadians will have missed out on the opportunity to shape this emerging industry.

We suggest the creation of limited functionality charters, or Fintech charters, whose requirements and responsibilities are commensurate with the risks created by the business. We are starting to see in other jurisdictions the creation of the limited functionality or Fintech charters, such as the 'special purpose national banks' being created by the Office of the Comptroller of the Currency (OCC) in the US. In the absence of Fintech charters, we suggest the creation of limited-time charters whereby companies can engage in bank-like activities during the early stages of company creation, prior to taking on a full charter. Either Fintech charters or limited-time would require the following to be effective:

- Cost of entry must be brought down by a clear and quick path to entry
- Timeline for approval must be far faster (e.g., 6 months or less)
- Capital requirements must be proportionate to assets held or current risks
- Ambiguity of the application outcome minimized through clear communication of requirements
- Simplified regulatory reporting

## **5. Positioning a Competitive and Innovative Sector to Support Long-Term Economic Growth**

**Question:** Competition in the financial sector can be a tool to deliver economic growth. In this context, the Department is seeking views on how best to ensure that the financial sector supports long-term economic growth, while balancing the need for a well-functioning and stable sector and, in particular, the role that small and mid-sized banks can play in enhancing the innovative and competitive potential of the Canadian economy.

### **Response:**

While our main arguments for the role that Fintech can play in delivering economic growth as well as enabling a competitive and innovative financial services sector can be found in our first submission, as attached, we would like to highlight two key levers to deliver on this mandate: access to data through open data or open banking legislation (see below) and the creation of a customer authentication and identity service as a shared utility.

We believe a critical lever to financial services innovation and efficiency lies in the digitization of identity. Current identification practices as seen under Know-Your-Customer ("KYC") and Anti-Money Laundering ("AML") requirements are inefficient, prone to error and highly insecure. Furthermore, current requirements run counter to the expectations of the modern consumer who expect seamless, instant, and easy onboarding for any products they use. The friction that is imposed on the customer onboarding process is often the difference between a prospective customer trying a service or walking away.

We believe the creation of a national KYC utility, such a being piloted by the Monetary Authority of Singapore<sup>4</sup>, would be a tremendously important competitive advantage to Canadian companies.

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<sup>4</sup> Finextra "MAS to roll out national KYC utility for Singapore", Finextra.  
<https://www.finextra.com/newsarticle/30332/mas-to-roll-out-national-kyc-utility-for-singapore>

If should be pointed out that the solution to a national KYC utility must be a shared resource that is accessible to all financial services players and cannot be used as a competitive advantage by a small group of players such as we are seeing through various private sector initiatives currently being explored within Canada, such as SecureKey.

## **6. Examining the Merits of Open Banking**

**Question:** The Department intends to examine the merits of open banking. This would include consideration of how other jurisdictions are implementing open banking and the potential benefits and risks for Canadians.

The Department is also seeking views on other specific adjustments to the federal financial sector framework that could further support competition and innovation.

### **Response:**

The global financial services industry is undergoing a secular technology, business model and regulatory shift driven in large part by new ways to effectively access, use, shape and monetize data through analytics, deep learning and artificial intelligence. Data has become the raw material of the modern economy. As a country, how we approach open banking and deal with questions such as data ownership, control, and usage will have a profound effect on how we will shape our economy going forward.

It is our view that open banking, or more generally, enabling consumers the ability to access all of their financial and transaction data wherever it resides is not only a fundamental right but also foundational lever required to support competition and innovation. To this end, we believe we should look at initiatives taking place around the world with a clear mandate of implementing our own opening banking initiative within Canada without delay.

Regarding the debate around how we can see open banking implemented in Canada there is the question of whether it should be a market based or policy based solution. We believe, due to the competitive dynamics within financial services more broadly, and within banking more specifically where the industry is dominated by a small group of large FRFIs, there should be a policy based or legislated solution. The United Kingdom's Competition and Markets Authority ("CMA") launched a market investigation in 2014 and published a report in 2016 which found that the market for personal and small business banking had all the characteristics of an uncompetitive market that was not operating in the best interests of the consumer and concluded that in a highly concentrated market it is in the best interests of the consumer to mandate open banking reforms rather than wait for a market based solution<sup>5</sup>.

In the absence of legislated open banking as currently exists in Canada we have seen very little movement on the part of FRFIs to open their systems through APIs to allow customers to access their data. In the limited cases where FRFIs have done so it has only been on a

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<sup>5</sup> Competition and Markets Authority, "Retail Banking Market Investigation: Final Report", August 9, 2016. <https://assets.publishing.service.gov.uk/media/57ac9667e5274a0f6c00007a/retail-banking-market-investigationfull-final-report.pdf>

proprietary basis (the FRFI chooses their 3rd party partner) as opposed to a truly open basis (the customer chooses their 3rd party partners). This is what market based solutions will look like which will limit innovation and competition. We believe it is both unhealthy and limiting for financial innovation to be decided within the boardrooms of our largest financial institutions.

Furthermore, in the absence of a legislated open banking solution and direct access to customer data, the market is forced to resort to sub-optimal short term solutions, such as data aggregation or 'screen scraping' to provide consumers with the services they are demanding.

As an investment firm that builds and invests in consumer facing Fintech services in Canada, FCP is on the front lines of this market dynamic and we see the limiting effect of this problem every day. To observe the manner in which a lack of open banking in Canada affects innovation, stifles competition and limits the choice of Canadian consumers it is instructive to observe the experience of actual Fintech services as they seek to acquire customers and provide services.

We believe legislatively mandated open banking solves many of these current problems through a clear set of rules governing consent, privacy, security, data usage, coupled with a standards based implementation of APIs. We see this process being rolled out in the United Kingdom, the European Union, Australia, and various Asian countries and observe a direct correlation between open data implementation and the creation of innovative financial services. Countries such as Canada or the United States where market based solutions are in place are falling behind.<sup>6</sup>

Concerns have been raised by financial institutions and organizations representing financial institutions in regards to open banking which generally centre around security, privacy, and the technological and compliance burden imposed on them.

Regarding security, we believe that empowering consumers with choice is not mutually exclusive from keeping their data safe. In fact, though a standards based implantation of APIs, consumer data will be far safer then under the current closed system. That consumers are willing to risk violating their user terms and use far less secure methods to provide their data to 3rd party services tells us that the market has spoken and the onus is on us to find the most secure method to satisfy their needs with a safe, controlled, monitored, and rule based system.

In terms of privacy, we believe that it is only under an open banking system will consumers finally have true control over their own data. In fact, many of the motivations behind European PSD2/XS2A legislation were concerns around ensuring consumers had control over their own data. As described above, consumers wish to use 3rd party services such as they are willing to provide this data to providers who operate under very limited oversight. While all Canadian businesses must comply with The Personal Information Protection and Electronic Documents Act ("PIPEDA") there is very little oversight as to whether businesses

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<sup>6</sup> Siddiqui, Nabeel, "Slow API adoption is dragging U.S. banking down", American Banker, May 10, 2107. <http://www.americanbanker.com/opinion/slow-api-adoption-is-dragging-us-banking-down>.

are compliant. We believe open banking is an excellent opportunity to bring privacy obligations into the regulatory fold by empowering regulators to audit for compliance.

Finally, FRFIs have concerns around the technological and compliance burden and cost imposed on FRFIs by open banking, particularly in light of the already onerous compliance obligations they are struggling to deal with post 2008 financial crisis. In regards to cost, we believe this to be overstated. An assessment made by the Open Data Institute for HM Treasury in the United Kingdom estimated the actual cost to implement the technology necessary for open banking was low and could take less than a year to implement.<sup>7</sup>

Furthermore, it is our view that open data should not be viewed as advantageous only to Fintechs. In fact, with their considerable market power and favourable reputation amongst Canadian consumers FRFIs are well positioned to capitalize upon the new products and services that can be created through open banking as well as opening up financial services to previously underserved customers. Rather than seen as a burden, the innovation this will catalyze should be seen as an opportunity. Furthermore, it is our view that digitization and the rapid creation of large open networks of online users is an enormous threat to incumbent organizations that remain closed and do not innovate quickly. That the digitization of financial services will take place is no longer being questioned, now it is a case of whether we will do it to ourselves or have it done to us by others. In this light, the technological and compliance burden must be shouldered by our financial services industry if we wish to remain relevant.

## **7. Limitations on Using the Terms “Bank”, “Banker”, and “Banking”**

**Question:** The Department is seeking views on whether prudentially regulated non-bank deposit-taking institutions should be given flexibility to use the terms "bank" or "banking" to describe their activities and services in appropriate circumstances. Feedback is welcomed on how to refine the limitations on the use of these terms and on how to avoid marketplace confusion and ensure appropriate protection of consumers.

**Response:** It is our view that the term “Bank”, “Banker” and “Banking” has evolved far beyond its original usage. Rather than denote a definite type of entity, it has been extended to describe a more broad series of activities such as lending, savings, investing and other financial services. Such are these terms routinely used that limiting their usage solely to prudentially regulated bank deposit-taking institutions subject to the oversight of OSFI would in fact cause greater confusion for the general public. This issue should be approached in the same manner as “broker” or “brokerage” which is used for any intermediary between buyers and sellers, be they in the securities, insurance, or real estate industries. Through clear disclosure and registration requirements, there is no confusion as to whether one is dealing with an insurance broker or stock salesperson. Therefore we would suggest that in the case of the usage of “banking” the focus should be on disclosure as to whether funds are CDIC ensured and subject to oversight by a regulator.

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<sup>7</sup> The Open Data Institute, “Data Sharing and Open Data for Banks: A report for HM Treasury and Cabinet Office”. September 2014.

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/382273/141202\\_API\\_Report\\_FINAL.PDF](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/382273/141202_API_Report_FINAL.PDF)

## CONCLUSION

While we are heartened to see the emphasis on financial services technology on the part of Finance Canada – particularly in areas of acute importance such as open banking – we caution that Fintech is a competitive and global movement that is moving quickly and we are deeply concerned that we are moving too slowly in Canada to implement the levers required to meet this competition. We must understand the problems, determine the solutions and move swiftly and with conviction.

Both Ferst Capital Partners and Ferst Digital thank you for the opportunity to make this second submission to comment on the Review of the Federal Financial Sector Framework. If you require further clarification on any of our positions or wish to discuss further we encourage you to reach out at your convenience. It would be our pleasure to work with the Department in any way that we can be useful.

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