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Financial Sector Policy Branch
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RE : Consultations on Federal Financial Sector Framework Review

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 federal government's review of the federal financial sector framework. Being able to obtain financing is essential to the success of SMEs in Canada, helping them with job creation, innovation, and growing the economy. With new players in the financial sector emerging, it is important that SMEs continue to have access to financing at a reasonable cost. As new technologies evolve and begin to become more commonplace in the financial sector, the federal government must ensure that regulations keep pace.

Trends in Financing for SMEs

Over the past few decades, CFIB has tracked the market share of financing institutions among SMEs. As such, we have been able to closely follow trends within the financial sector. CFIB recently released three reports on bank market share, financing indicators and SME ratings of their financial institutions. With regards to market share, our survey found that some larger banks have seen their market share of SMEs drop in the past few years, most notably CIBC (see Figure 1). Royal Bank's share has declined since 2012, whereas both Scotiabank and TD Canada Trust have risen to second and third place, respectively. Notably, there was a significant rise in the market share of credit unions, which have now surpassed both the

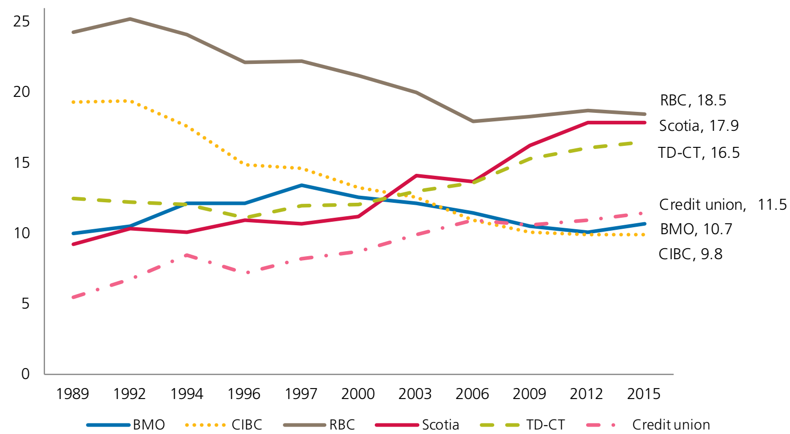
"Large banks business fees and charges are ridiculously overpriced. The time it takes for transactions can be excessive. I do not have this problem with a credit union."

Automotive Repair, AB

Bank of Montreal and CIBC. In fact, between 1989 and 2015, the market share of credit unions has more than doubled from 5.5 per cent to 11.5 per cent.

Figure 1:

SME Market Share, Big Banks and Credit unions, 1989-2015 (% businesses)

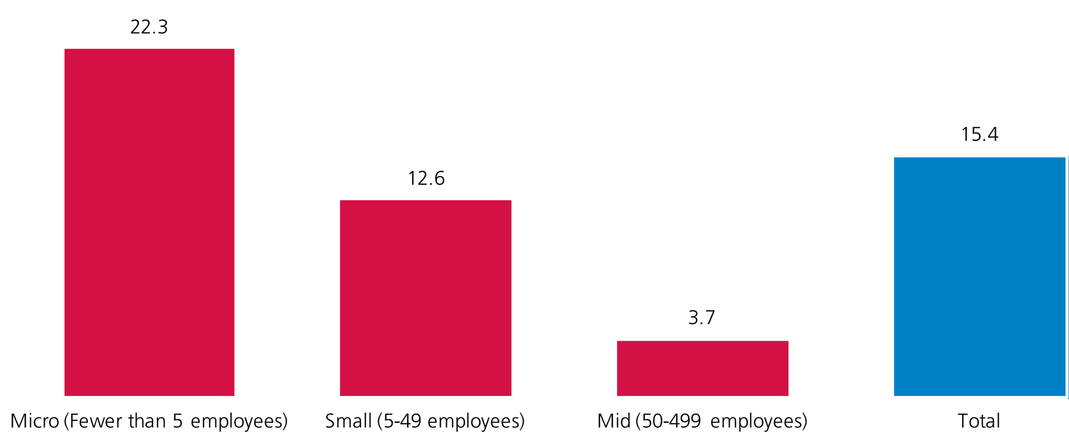


Source: CFIB, SME Bank Market Share, 11,400 responses, August 2016.

CFIB asked members to rank their financial institutions on four areas: financing, fees, account manager, and service. Credit unions consistently ranked higher than the big banks in all these areas, particularly service. Additionally, credit unions rated higher than large banks in the area of financing. They are much more likely to lend to micro (fewer than 5 employees) and small (5 to 49 employees) businesses than larger banking institutions. Smaller and newer businesses have more difficulty accessing financing than larger or more established SMEs. Loan rejection rates are significantly higher for micro businesses than small or mid-size businesses (see Figure 2). Also, smaller businesses generally face much higher costs when trying to access financing. As they are considered to be higher risk, they are charged higher interest rates.

Figure 2:

Loan Rejection Rates by Size of Business (% response)



Source: CFIB, SME Financing Indicators,11,400 responses, October 2016.

Small business owners are looking for value for the services they receive from their financial institution and they want to feel as though their account manager cares about their business. They value face-to-face interactions and knowing that their account manager is familiar with their business. Overall, bank fees were the biggest complaint for small business owners of all sizes. In CFIB's monthly Business Barometer, 38 per cent of business owners stated that the costs related to banking are among the biggest cost constraints for their business.[1] Some CFIB members commented that the cost of fees was a major reason for switching from a large bank to a credit union. With new players and technologies entering the market, the federal government must ensure that fees are kept reasonable and small businesses are receiving the services they pay for.

New Entrants in the Financial Sector

Financial institutions are also increasingly moving their services online. As this trend continues, SMEs are concerned with the increased costs of both making and accepting electronic payments. For example, over half of businesses cite the cost as a barrier to implementing a new system to accept electronic payments.[2] These costs can include equipment rental, operating costs, and processing fees – which can be much higher for online payment processing or point of sales systems. Over a quarter of business owners also expressed concerns about online security when using electronic payment systems.

Due to these barriers, SMEs have been much slower to move online for business-to-business and business-to-government transactions. We recommend that rather than increasing fees on paper-based banking, financial institutions should instead encourage SMEs to move online by reducing their fees for registration and receiving online payments. Additionally, incentives should be provided to SMEs to use these new, more efficient services not only for their own banking, but also for business-to-business and business-to-government transactions. For example, one low fee should be enforced for SMEs making online payments to government (e.g. for tax remittances) instead of the high fees currently in place.

Traditional financial institutions are not the only ones involved in online financing now. As new players such as fintechs enter the market, there could be repercussions for SMEs if they are not considered in government policies and legislation. Currently, most fintechs provide online payment and checkout platforms, as well as payment processing (e.g. Square). However, fintechs, such as Kabbage, are moving into the lending game as well—some specifically targeting their offerings to the small business community.

"Banks should make government remittance payments easier to use online and free. Also, mobile deposits very much helped alleviate the need to rush to the bank on a regular basis."

Web Design Acency, QC

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1 *CFIB, Business Barometer, 651 responses,* October 2016.
2 *CFIB, Changing the Way We Pay, October 2011.*

Applying for loans and financing online may seem convenient to a small business owner pressed for time. However, current legislation and policies regulating the financial industry do not yet take these new entrants into account, as these fintechs are not traditional banking institutions. Additionally, online applications rarely offer the same level of detail and thoroughness as would a face-to-face interaction with an account manager at a credit union or bank. This may result in applications for financing being rejected when they should not be, due to the fact that they do not take into account a business's entire situation or history. Automation of certain financial services may be convenient, however, it must be stressed that the knowledge provided through an account manager's relationship with their SME client is essential to properly determining risk.

> *"I'm worried that the customer/manager type relationship will disappear in the future and move to robotic algorithms."*
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> Taxi Service, AB

Going Forward

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.
- 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 that they do not become a type of "payday" lender for SMEs.
- Introduce an independent monitoring agency, similar to the Financial Consumer Agency of Canada (FCAC), that 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 and 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.*

Online and e-banking technologies are moving at an incredible pace and they present opportunities for increased competition in the financial sector. Nevertheless, it is important to ensure that the industry remains transparent and accountable to their small business clients.

Thank you for the opportunity to participate in these consultations. Should you have any questions or concerns, you can reach our office at or by email at or .

Sincerely,

Corinne Pohlmann
Senior Vice-President, National Affairs and Partnerships

Monique Moreau
Director, National Affairs

Encl. :
CFIB, *SME Bank Market Share*, August 2016
CFIB, *SME Financing Indicators*, October 2016
CFIB, *Battle of the Banks*, October 2016