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Re: Review of the Federal Financial Framework

Submission from Dr. Jerry Buckland, Menno Simons College, University of Winnipeg and Dr. Gail E. Henderson, Queen's University Faculty of Law

The comments below respond to the following Questions for Consultation set out in the consultation paper "Supporting a Strong and Growing Economy: Positioning Canada's Financial Sector for the Future".

> Question 2. "How well does the financial sector framework currently balance trade-offs between the three core policy objectives of stability, efficiency and utility?"
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> Question 4. "What actions could be taken to strengthen the financial sector framework and promote economic growth, including with respect to the identified themes? How should those actions be prioritized? For example…How can the financial sector framework support financial firms to best serve the evolving needs and interests of consumers?"

Our overarching concern is that the current regulatory framework, even taking into account recently introduced amendments to the *Bank Act*, will not do enough to further the goals of financial inclusion and financial empowerment of Canadians living on a low income or with low or no assets. Achieving these goals will require the big six banks which dominate the banking landscape in Canada to meet the needs of low-income and low-asset Canadians to access small, short-term loans and asset-building accounts. Amendments requiring better disclosure by the banks and efforts to improve the financial literacy of consumers are laudable, but are insufficient to achieve the goals of financial inclusion and financial empowerment, which should be explicit objectives of the federal financial framework.

The 2016 consultation paper defines "utility" as "the sector meets the financial needs of an array of consumers, including businesses, individuals and families, and the interests of consumers are protected". The consultation paper notes that "Certain Canadians, including seniors, new Canadians and those in remote communities, may be faced with particular challenges", including that "[c]onsumers may not have easy access to traditional small short-term fixed loans and instead draw on revolving credit". The "certain Canadians" not specifically named in the consultation paper are Canadians living on a low income and/or Canadians with low or no assets. This group are the least likely to be well-served by the banks, in comparison to seniors, students and newcomers, because they present the weakest business case for specially targeted services, and because they present challenges to financial institutions beyond financial literacy or accessibility, although these issues also may be present among members of this group. They also are the group most affected by some of the problems mentioned in the paper, including lack of access to short-term fixed loans and reliance on revolving credit, such as payday loans. As such, low-income and low-asset Canadians, including First Nations, Metis and Inuit who fall into this category and face additional barriers, present the strongest case for legislative provisions and regulations targeted specifically at ensuring their banking needs are met.

It may be thought that the needs of this group are addressed in the amendments to the *Bank Act* proposed in Bill C-29, which received first reading in the House on October 25, 2016. In order to address the consultation questions listed above, it is necessary to consider these recently proposed amendments.

These amendments were first considered in the 2013 budget. A consultation paper was published in December 2013 and comments in response closed February 2014. The purpose of the amendments was to create a "comprehensive financial consumer code" which would, among other things, "[r]espond to…the needs of vulnerable Canadians" and "[b]e simple and clear in providing expectations for the accountability of financial institutions". Although the 2013 consultation paper discusses the challenges faced by "vulnerable Canadians" and the need for financial institutions to respond to their specific needs and to improve access to financial services through low-cost financial products, again, low-income Canadians are not specifically mentioned.

The proposed amendments include new Part XII.2 of the *Bank Act*, "Dealings with Customers and the Public". Proposed section 627.02 set out the principles on which the new Part is based. These principles include the principle that "basic banking services should be accessible" and that "an institution should act responsibly, considering its customers and the public as well as the efficiency of its business operations." Although these principles might be interpreted broadly to include responding to the needs of vulnerable consumers, this responsibility should be made explicit.

The proposed new section 627.04(4) requiring banks to offer a low-cost or no-cost deposit retail account is an important improvement to the existing regulatory framework. However, the lack of an accompanying positive obligation to disclose or advertise this option to consumers, instead specifying that this option must be provided on request, puts the onus on vulnerable consumers to be aware of and ask for this option.

Proposed section 627.91 deals with the content of public accountability statements ("PAS"), currently required under existing section 459.3. The proposed section would require large banks[1] to include in their annual PAS "a description of the measures taken by the bank and its prescribed affiliates to provide products and services to persons facing accessibility, linguistic or literacy challenges". As noted above, low-income and low-asset Canadians may face accessibility, linguistic or literacy challenges, but they also face challenges related specifically to their low income and having low assets. Although the proposed amendments would require large banks to disclose on how they have consulted with customers and the public on new products or services, it is likely that banks will focus their efforts on those groups with greater market potential. The existing PAS Regulations[2] require banks to report on initiatives undertaken in the past year "to improve access to financial services for low-income individuals". Notwithstanding this requirement, a review of the big six banks' PAS statements published in 2015 confirm earlier research[3] that there is very little mention of financial products geared specifically to low-income Canadians who are not students, seniors or recent immigrants. Products which are mentioned are frequently limited to a low-fee bank account which caps the number of transactions per month covered by the monthly fee. Most students would qualify as "low-income", but it seems likely that their access to financial services would be provided regardless of these reporting obligations on the basis that it is an effective way for the bank to generate loyalty among a group who are likely to be earning significantly higher incomes in the near future. Similarly, there is a long list of services geared specifically to newcomers in the hope that they will soon be in a position to qualify for other banking services. RBC makes the business case for offering services geared to newcomers explicit at page eight of its 2015 PAS: "The newcomer to Canada segment is a key client segment for RBC. Providing newcomers with competitive and relevant card products supports our efforts to develop long lasting relationships." The Government has missed an opportunity to make "simple and clear" the expectations on large banks to improve products and services aimed at the particular and important needs of low-income and low-asset Canadians by strengthening the disclosure requirements of the PAS with respect to this group.

On the whole, the proposed new Part XII.2 focuses on improving disclosure and consent requirements. These are laudable improvements which will benefit the consumers at whom these products are aimed. Apart from the requirement to offer a low or no-cost retail deposit account, however, they do not expressly require banks to expand their product offerings to include credit or asset-building products specifically designed to address the special needs of low-income and low-asset Canadians. The proposed PAS content requirements are too vague to nudge banks into providing these products.

Canada's banking sector is highly concentrated and it is becoming more concentrated over time. As noted in the consultation paper, Canada's six largest banks hold "93 per cent of assets in the

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[1] I.e., banks with equity of $1 billion or more.

[2] *Public Accountability Statements (Banks, Insurance Companies, Trust and Loan Companies) Regulations*, SOR/2002-133.

[3] Passing the Buck? Examining Canadian Banks Approaches to Financial Exclusion, Research and Working Paper # 49, Winnipeg: Institute of Urban Studies, the University of Winnipeg.

banking sub-sector". The lack of competition, in addition to general market failure, helps to explain the failure of these banks to offer products appropriate for low-income Canadians which would help them to build savings and to manage debt. This failure has a substantial impact on this group, essentially ensuring that they will remain reliant on revolving credit, such as payday loans, which do not assist them in terms of building savings or even a credit rating. Bank branch closures have often disproportionately hurt poor inner-city neigbourhoods, as evidence in studies of Winnipeg[4] and Toronto[5]. Ensuring that low-income Canadians are well-served by the big six banks which dominate the market is necessary to reduce asset inequality in Canada. Encouraging growth in the credit union sector may help this effort primarily because some credit unions have a social-economic mission and have innovated unique products for the excluded (e.g., Vancity Credit Union, Assiniboine Credit Union). However, the credit union system is too small to address the challenge on its own. Bank engagement with financial inclusion is unlikely to happen without specific regulations, particularly in an environment in which low interest rates are reducing bank profits on core lending products. At the very least, it should be made clear in the *Bank Act* that banks are expected to serve the specific needs of this segment of the population and are accountable to the public to demonstrate that they are doing so. This expectation should be reinforced through enhancements to and stricter enforcement of the *Access to Basic Banking Services Regulations*.[6]

The problem of under-service of low-income and low-asset Canadians should not be underestimated. The 2016 consultation paper makes reference to 1% of Canadian adults as unbanked. We do not know where this data point has come from but we are skeptical about it. This is because standard survey methods under-represent unbanked and under-banked adults. One activity of the McKay Task Force[7] was to estimate the unbanked population in Canada using survey methods that tried to represent low-income people who are more likely to be unbanked and unreached by ordinary surveys. That method led to the result that 3% of adults were unbanked. Even if we were to accept the 1% figure, there are still many Canadians who are underbanked and rely on fringe banks such as payday lenders, title lenders, and auto lenders. The framework is not directly addressing these issues but we believe that the existence and in some cases the growth of sub-prime lenders is the consequence of financial exclusion.

Arguably the current framework needs to be more active in addressing the utility objective. The report notes that household debt is on the rise and that there are an increasing number of increasingly complex financial products. The objective of utility, as defined in the consultation paper, does not sufficiently addresses these problems. Specifically this goal needs to explicitly and deliberately promote financial inclusion, that is, the ability of all Canadians to access appropriate and safe financial services. This would be in keeping with the McKay Task Force on

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[4] Brennan, Marilyn, Brian McGregor, and Jerry Buckland. "The Changing Structure of Inner-City Retail Banking: Examining Bank Branch and Payday Loan Outlet Locations in Winnipeg, 1980-2009." *Canadian Journal of Urban Research* 20, no. 1 (Summer2011, 2011): 1-32.

[5] Simpson, Wayne and Jerry Buckland. "The Dynamics of Financial Institution Location in Toronto: Who is Serving the Inner City?" *Economic Development Quarterly* (forthcoming): 1-29.

[6] SOR/2003-84.

[7] MacKay, Harold. *Task Force Report on Future of Canadian Financial Services Sector (MacKay Report)*. Ottawa: Department of Finance, Canada, 1998.

Financial Sector Reform in 1998 which included its 3rd objective as ensuring banks ‘meet their social obligations,’ and it included the goal of empowering financial consumers. The McKay approach had inclusion more clearly as a part of the objectives.

In conclusion, to answer the specific consultation questions set out above –

> In response to Question 2. The balance struck by the current regulatory framework, taking into account the proposed amendments in Bill C-29, fails to consider adequately the specific needs of low-income and low-asset Canadians, who are least likely to be well-served by banks without specific government interventions.
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> In response to Question 4. Economic growth must be *inclusive* economic growth. Inclusive growth requires ensuring that the needs of low-income and low-asset Canadians are met by the big six banks, given the highly concentrated nature of Canada’s banking sector. Market forces will not respond to the needs of this group in a manner that allows them to build savings and escape the revolving credit trap.

Sincerely,

Dr. Jerry Buckland

Dr. Gail Henderson