



The Trust Companies Association of Canada

November 15, 2016

VIA EMAIL AND COURIER

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

Dear Sir/Madam

**Re: Department of Finance
Consultation To Review the Federal Financial Sector Framework**

Attached please find The Trust Companies Association of Canada (TCA) submission on the Federal Financial Sector Framework.

The Trust Companies Association of Canada Inc. would like to thank the Department of Finance for giving the TCA the opportunity to provide feedback on the Federal Financial Sector Framework Consultation.

By way of background, the TCA was incorporated under the *Canada Corporations Act* on January 21, 1986 and on August 11, 2014 the TCA was continued under the *Canada Not-for-Profit Corporations Act*. The TCA represents 21 small to mid-sized financial institutions. The TCA advocates for effective public policies that contribute to a sound financial system, benefitting Canadians and Canada's economy.

The objectives to the TCA are to: (i) foster sound and equitable principles in the conduct of all phases of the financial industry; (ii) afford through meetings and otherwise opportunities for consultation and co-operation in matters of interest and importance to TCA members; (iii) gather, research and distribute information of interest and value to TCA members; (iv) promote the interests and welfare of members and those they serve; and (v) represent the interest of the TCA in consultation with governments and consumer groups and other associations and financial institutions and before the public.

Sincerely,

Trust Companies Association
Andrew Moor, Chair



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OVERVIEW

The Trust Companies Association of Canada (TCA) supports the government's core policy objectives of stability, efficiency and utility outlined in the consultation document. We recognize the need for the sector to adapt to an ever-changing environment and appreciate the opportunity to provide the following submission for your consideration.

1. What are your views on the trends and challenges identified in this paper? Are there other trends or challenges that you expect to significantly influence the financial sector going forward?

We believe the combination of the current regulatory and economic trends identified in the paper place non-DSIB financial institutions in a challenging position and make it difficult for new participants (that are non-DSIBs) to enter the financial sector.

With respect to the regulatory trends, non-DSIB financial institutions are being affected negatively on three fronts. First, the increasing administrative cost of regulatory compliance is growing. For example, additional personnel are required to manage, monitor and adhere to these regulatory requirements and expensive database systems are necessary in order to collect, store and sort information that is being asked of FI's for regulatory reporting purposes. Although the volume of data for small/medium sized FI's is not as large as the DSIBs, small/medium sized FI's will still need to invest in software that will allow for detailed reporting specific for regulatory purposes. It is much more difficult for non-DSIBs to absorb those costs given the economies of scale.

Second, framing legislative changes such that non-DSIBs are better able to leverage certain aspects of fintech (such as cloud computing) would help promote competition and consumer offerings without affecting the stability of the financial sector.

Additionally, OSFI is placing tighter constraints on liquidity. Liquidity adequacy rules require all FI's to maintain liquid assets and ensure sufficient funding is available during times of stress. These rules place additional burdens on smaller institutions because their sources of funding are limited. This in turn also limits non-DSIB's ability to grow their asset portfolio in a competitive environment. More specifically, because of the reliance on the deposit broker channel for many of our members, concluding the consultation on access to brokered deposits with legislative changes would help ensure the continued stability of the sector and support competition to benefit all Canadians.

With respect to the current economic environment, a major source of revenue (interest margin) is diminishing due to the low interest rate environment. While DSIBs are large enough to diversify and expand into other business areas (such as wealth management, insurance, etc.) that are not directly impacted by the compressed financial margin, it is more difficult for non-DSIBs to diversify due to their size and the constraints mentioned in the previous paragraph.



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2. How well does the financial sector framework currently balance trade-offs between the three core policy objectives of stability, efficiency and utility?

Generally, while we understand the need to balance the three core policy objectives, we are concerned, in ensuring stability and utility, that efficiency has been left behind. The potential impact on small institutions with respect to increased regulatory burdens is proportionately more impactful than on larger institutions. Smaller institutions are forced to expend a disproportionate amount of resources compared to their larger counterparts in order to comply with an increasing amount of regulatory requirements, which creates inefficiencies since those resources cannot be used to help otherwise grow the institution and support its clientele.

The impact of this focus away from efficiency could result in increased risks to consumers. By focussing on entities that are already regulated and increasing their reporting requirements as opposed to focussing on non-prudentially regulated entities (also known as 'shadow banks'), Canada is creating a three-tiered system: (i) large regulated entities that can spread increased regulatory costs amongst millions of customers and thereby minimize the impact on the institution, (ii) smaller institutions that cannot bear increased regulatory costs over a smaller revenue base, and (iii) unregulated entities that are not impacted by tightening regulations. This reality causes a concern that the non-prudentially regulated sector will grow faster than the prudentially regulated sector which may decrease the stability of the financial sector as a whole. Consumers may be disadvantaged in that they do not benefit from access to the protections of CDIC and FCAC.

We would also point to OSFI's small and medium-sized institution initiative as an example of strong messaging about collaborative regulation and way of promoting efficiency via regulation and would encourage the Department of Finance to consider a similar initiative to help ensure small and medium-sized institutions are afforded a direct and dedicated channel in this regard.

3. Are there lessons that could be learned from other jurisdictions to inform how to address emerging trends and challenges?

On the positive side, some jurisdictions have implemented, or are in the process of implementing, frameworks to encourage newcomers and incumbent players to cooperate. For example, the United Kingdom has introduced a platform for fintech companies to work with banks; Europe has developed regulations to enable access to accounts (European Banking Authority's Payment Services Directive, for example); global initiatives have been implemented to enable modern interaction between players (openAPI); and Ontario has developed a multi-tiered regulatory system for credit unions, based upon size and product lines, which could be used as examples for a Federal system with diversity based both upon size and business models.

Additionally, in the last few years, the United Kingdom has implemented a new system designed to make it easier and quicker for customers to switch their current accounts from one bank to



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another and is considering linking bank accounts to phone numbers to allow a more portable way of banking for consumers.

We believe that the experiences from other jurisdictions, both the good and the bad, are instructive for the Canadian financial sector, and in particular the ability of non-DSIBs to address the ever-changing needs of consumers in a constantly evolving marketplace.

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?

How should the financial sector framework support innovation and competition while maintaining stability of the system?

One way for the financial sector framework to support innovation and competition while maintaining stability of the system would be for the Government to create a regulatory framework to simplify online commerce by allowing for the development of the e-ID verifying of actors, leaving execution and implementation to service providers.

How can the financial sector framework best promote competition, including by encouraging new entrants and fostering the growth of small entities and other players?

As discussed above, regulatory compliance has become an increasing responsibility for smaller institutions and this results in weakening competition by placing a greater proportional cost burden on those institutions. As a result, we believe that competition would increase if the Government considered minimizing regulatory reporting requirements for certain areas where this disproportionate requirement exists to more appropriately take into consideration the different size and business scope of smaller institutions compared to their larger counterparts.

With respect to federal trust companies specifically, we would also recommend implementing information sharing initiatives between the federal and provincial regulators that could help minimize or eliminate expensive and time intensive provincial filings. We believe this would help increase competition and foster growth of smaller institutions as it will allow those institutions to re-allocate resources to other growth initiatives instead of duplicate reporting.

We would also suggest that, as part of the review of the financial sector framework, consideration be given to reviewing the payments and settlement system in Canada, and in particular the ability for smaller entities to gain direct access to the Automated Clearing and Settlement System (ACSS) and Large Value Transfer Systems (LVTS). We believe that modernization of the qualification criteria is warranted given the original criteria was developed when the use of cheques was commonplace and that no longer reflects the modern realities of e-commerce in Canada.



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How can the benefits of an internationalizing financial sector best be obtained while ensuring the safety and soundness of the sector?

Generally speaking, our members are not active internationally; however we are interested in discussing best practices to promote the three core policy objectives and would therefore encourage the Department of Finance and core entities in payments (for example, the Bank of Canada and Payments Canada (formerly the Canadian Payments Association)) to continue to promote international standards, to allow exchange of payment related information (ISO 20022) amongst industry players in other jurisdictions.

How can the financial sector framework support financial firms to best serve the evolving needs and interests of consumers?

With respect to the interest of consumers, a level playing field is required to foster competition. While we do appreciate the current attempts to tailor regulation to medium and small institutions, it should be noted that such "scaling" wouldn't necessarily ease the burden or create a level playing field between larger institutions and smaller institutions or even between smaller institutions, since each institution may have a very different business model - smaller institutions are not necessarily homogenous and there may be great differences in business models, including branch versus non-branch models. One example of where these different models can result in very different regulatory outcomes is with respect to the recent changes to AML legislation, which provides far greater relief to branch-type institutions than it does for non-branch institutions. As a result, we believe the financial sector framework needs to be more flexible to take into account not only size differences between institutions but different business models.

While recognizing that certain minimum standards are necessary, we feel that regulatory changes which would help medium-sized institutions migrate towards AIRB is desirable for the sector. We therefore would suggest that regulatory changes explore the possibility of a graduated modelling system which would allow evolution over time in order to give medium-sized institutions access to more sophisticated risk management available under AIRB.

Are Canada's federal financial sector oversight bodies well-positioned to support the sector in the future?

While we believe that the Canadian financial sector oversight bodies are doing a good job, the main issue facing the financial sector is whether the framework these oversight bodies work in is flexible enough to account for not only small, medium and large institutions, but different business models and the rise of shadow banking. The stability of the banking sector is influenced by the stability of the environment and shadow banks have the potential to destabilize the system.



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5. What other actions should be taken to ensure the financial sector framework remains modern and technically sound?

In order to ensure the financial sector framework remains modern and technically sound, we encourage the Department of Finance to continue to keep abreast of international standards (ISO) and to expedite and, if possible, invest in and promote new technology (e.g. Blockchain, OpenAPI) and innovation.

We have also observed that a prescriptive approach to regulatory oversight may hamper the sector's ability to evolve and as such would suggest an approach that balances prescription with a more principles-based regime, particularly in the area of outsourcing (OSFI Guideline B-10) for example. Likewise, AML regulation is prescriptive by nature, but, interpretation of the regulations could be more nuanced to allow policy objectives to be met while allowing banks to operate efficiently. We recognize the need for certainty in regulation, however we believe there are opportunities, such as the ones noted above, where advancements in an increasingly digital environment will be better taken into account.

Other Comments

We believe that expanding the scope of these reviews beyond financial institution legislation could also be helpful. For example, the Canada Revenue Agency deemed trust of super-priority, i.e. section 227 of the *Income Tax Act*, can have a large effect on a small institution. A super-priority allows the Canada Revenue Agency to claim against proceeds received from a business, such as for a mortgage, long after that mortgage has been paid out. This could happen even if the institution performed all due diligence before making the loan. Such a priority could result in institutions taking hard looks at the types of business they offer and help minimize consumer choice. As a result, we would recommend broadening the scope of review to also take into consideration other relevant statutes which affect financial institutions, such as the *Income Tax Act* so as to be cognizant and avoid any unintentional gaps.

We would also suggest a repeal of the sections in the *Trust and Loan Companies Act* (TLCA) which are either (i) no longer relevant, and/or (ii) which hinder the achievement of the three core policy objectives of stability, efficiency and utility. By way of example, the sections in the TLCA that apply restrictions on commercial lending (sections 461-463) act to stifle competition and it can be a challenge for an institution to meet the ever changing needs of consumers, and the sections in the TLCA which require an entity to identify on its books assets equal to the aggregate amount of its accepted deposits (section 425(5) seems to be an antiquated anomaly and our understanding is that the practice itself was rendered obsolete when legislation was changed to allow Canadian banks to own trust companies.

As a final point, we believe there would also be a benefit to try to seek an alignment of the *Bank Act* and the TLCA, where possible. We believe that this would serve to promote efficiency in the sector as supervisors would be working under rules that are generally the same and would help to promote a more consistent approach across all deposit taking institutions.



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In closing, we appreciate the opportunity to provide our comments on the consultation document. Our recommendations are intended to support the stated objectives of stability, efficiency and utility and we look forward to participating in the second phase of the consultations process following the release of the policy paper in 2017.
