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Canada's Competition Bureau Releases Draft Fintech Report: What's Next?

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In May 2016, Canada's Competition Bureau announced that it was launching a market study into technology-led innovation in the Canadian financial services sector, also known as "fintech." Eighteen months later, in November 2017, the Bureau released a detailed draft report for comment. Below we provide an overview of the key issues discussed in the Bureau's draft report and possible implications for companies operating in the fintech area in Canada.

Background: Why Fintech?

The number of fintech companies operating in Canada is on the rise. According to a recent study by OMERS Ventures, approximately 100 fintech firms operate in Canada and over $1 billion has been raised for the funding of Canadian fintech firms since 2010. However, as EY reported last year, the Canadian adoption rate for fintech products remains relatively low – at 8.2% compared with the global average of 15.5%. EY has forecast, however, that if awareness of the available fintech products and services increases, Canadian adoption rates for fintech services could triple within a year.

The Bureau's stated objective in launching the market study is to help the Bureau advise and guide financial sector regulators (and other relevant authorities) on how to ensure that regulation does not unnecessarily impede innovation and competition. The key issues that the Bureau has been exploring are the competitive impact of fintech on the financial services industry, barriers to entry faced by new entrants and the need for regulatory reform to promote greater competition while maintaining consumer confidence in the financial services sector.

The Bureau's perspective regarding the need to encourage innovation in the fintech area was apparent from the materials it released in conjunction with the May 19, 2016 announcement of its market study as well as speeches by Commissioner John Pecman discussing the initiative. More specifically, Bureau representatives have stated that innovation by fintech companies offers the potential for greater consumer choice, more efficient services, lower fees and greater savings for consumers in Canada.

Over the past 18 months, the Bureau has consulted with over 100 stakeholders and hosted a one-day workshop in February 2017 at which representatives from fintechs , established financial institutions as well as domestic and international regulators discussed competition, innovation and regulation in the area.

The Bureau's Draft Report

In March, the Commissioner of Competition gave a speech in which he summarized some of the input that the Bureau had received from stakeholders. In May, the Bureau also published a preliminary summary of the key highlights from its fintech workshop and finally in November, the Bureau published its draft report for public comment.

The Bureau's report focused on three broad service categories: (1) payments and payment systems; (2) lending, including consumer and SME lending and equity crowdfunding; and (3) investment dealing and advice (including "robo-advisors"). The Bureau's report delves into these three areas, providing observations on the current regulatory and competitive landscape in each area and certain recommendations for "financial sector policymakers, regulators, industry participants, SMEs and consumers." These recommendations are likely to shape the Bureau's perspective on the need for any future enforcement as well as its advocacy-related efforts in the area.

A number of the Bureau's recommendations relate to the existing and future regulatory landscape, noting that any fintech regulation should minimally intrude on market forces, be technologically neutral and imposed only as necessary to further legitimate policy objectives so that Canadian fintech companies can continue to innovate, grow and compete globally. Certain key recommendations are discussed in more detail below.

1. Fintechs need greater access to core banking services and infrastructure

The Bureau's report recommends that "regulators should promote greater access to core infrastructure and services" to facilitate the development of innovative fintech services. In particular, access or greater access by fintechs to bank accounts and payments infrastructure (including clearing, exchange and settlement) would enable more market participants to offer new services to customers.

Access to banking services

The Bureau's report states that several fintechs expressed difficulty in obtaining the basic banking services required to operate, noting that payment service providers and/or money-transfer firms (a category of business defined under the Financial Transactions and Reports Analysis Centre of Canada [FINTRAC] as money service businesses, or MSBs) have faced delays in getting banking services set up and have had their services terminated with little to no explanation. The Bureau observed that few institutions appear to be willing to provide services to MSBs as a result of concerns regarding compliance with requirements under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*, even though MSBs must also comply with these obligations.

The Bureau also pointed to efforts by other international regulators to signal support for fintech startups to receive basic banking services, noting that the United Kingdom's Financial Conduct Authority has warned that banks should not use anti-money laundering "as an excuse for closing accounts when they are closing them for other reasons."

Access to exchange, clearing and settlement

Concerns regarding access to exchange, clearing and settlement infrastructure were raised by certain fintechs in submissions made to the Bureau as part of the market study. In its draft report, the Bureau picked up on this concern and noted that access to key exchange, clearing and settlement infrastructure such as the Automated Clearing Settlement System (ACSS) and Large Value Transfer System is limited.

In order to access the ACSS, membership in Payments Canada is required and the *Canadian Payments Act* outlines the requirements and restrictions for membership. The Bureau is of the view that the restrictions on accessing the ACSS as a "direct" clearer may negatively affect competition in the payments space because direct clearers can act in a manner that raises competitors' costs for those who cannot access the ACSS directly.

As fintechs are currently ineligible for membership in Payments Canada, many fintechs cannot access the ACSS directly in any capacity (whether for exchange, clearing or settlement). The Bureau's draft report notes that allowing fintechs to access the exchange aspects of the ACSS would "be sufficient to alleviate this major barrier to entry."

Implications

The Bureau's draft report clearly signals that it has concerns regarding the current ability of fintechs to access banking services and clearing and settlement infrastructure. Since access to the clearing and settlement framework is regulated, it is likely to be the subject of the Bureau's continued advocacy efforts (but is unlikely, on its own, to be the subject of enforcement action by the Bureau).

The issue of access to banking services from financial institutions by a money service business was considered by the Competition Tribunal under the *Competition Act*'s refusal to deal provisions in 2005. Under the refusal to deal provisions, a person who is unable to obtain adequate supplies of a product due to insufficient competition among suppliers in the market may apply to the Tribunal for an order that a supplier accept that person as a customer. However, in the 2005 case, the Tribunal held that a major Canadian bank's decision to deny banking services to a money service business was not the result of insufficient competition but based on objectively justifiable business reasons, and it dismissed the complaint. In that case, the Tribunal held that the justifiable business reasons included the fact that the complainant did not meet its obligations under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*. That said, financial institutions would be wise to evaluate their business justifications for any denial or limitation of banking services to fintechs , given the Bureau's interest in the area and the additional scrutiny to which these decisions may be subjected.

2. Canada should consider "open banking"

The Bureau's draft report also advocates for the benefits of "open banking" on the basis that it would facilitate customers' ability to shop around and switch service providers. The concept of open banking would allow fintech companies to build application programming interfaces (APIs) that allow customers to share their information securely with other banks and third parties.

The Bureau's position on this issue may have been inspired by initiatives from the U.K. Competition and Markets Authority (CMA), which has already taken steps to encourage open banking, including a requirement that U.K. banks implement open banking by early 2018.

The Bureau does not have the authority to require the implementation of open banking. However, and perhaps not coincidentally, in August 2017, Canada's Department of Finance launched second stage consultations on the renewal of the federal financial sector framework and sought views on open banking as part of that consultation.

Implications

Some stakeholders in the financial services industry have already highlighted the need to take into account not only concerns associated with consumers' security and privacy but also the potential impacts that an open banking initiative could have on the safety, soundness and stability of the financial system in Canada. Globally, however, the concept of open banking seems to be building momentum, with all but one of 100 payment executives at major banks looking to make significant investments in open banking by 2020, according to a recent survey conducted by Accenture.

Conclusion

The Competition Bureau has clearly invested significant resources into the fintech market study and its draft report. In light of this major investment and the knowledge base the Bureau has developed, it is likely to continue to look for opportunities to engage in advocacy efforts in the area and, if necessary, take enforcement action to ensure that innovation and competition in the fintech sector can continue to flourish.

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