Fintechs Canada

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Manuel Dussault,

On behalf of Fintechs Canada, I would like to thank you for the opportunity to provide the Department of Finance with our perspective on upholding the integrity of Canada's financial sector.

Fintechs Canada is the unified voice for the most innovative financial technology companies in Canada. Serving millions of Canadians daily from across Canada, our membership consists of market-leading Canadian fintechs, fintech-friendly financial institutions, the technology companies that power the credit union space, and global fintech companies, among others. Our mission is to assist Canadians in accessing a more competitive and inclusive financial sector, while also upholding the sector's integrity, stability and security.

In the rest of submission, we submit the following recommendations:

1. The Department of Finance should launch a review of responsible competition and innovation in Canada's financial sector. The review should entail the creation of a financial innovation and regulatory council, an assessment of the mandates of financial sector regulators, and a final report to the Minister of Finance with recommendations.
2. The Department of Finance should require Payments Canada to do more than it has suggested it would do in public consultations to protect consumers from fraud. In particular, the federal government should ensure that Payments Canada has a clear and predictable liability framework. We elaborate on what this means below.

3. In the event it's not feasible to work with the provinces and deliver something in a timely manner, the Department of Finance should consider alternatives to working with the provinces to develop a harmonized approach to market conduct supervision of non-financial institution payment service providers. The federal government could consider a code of conduct, such as Australia's ePayments Code.

1. Sectoral structure puts consumers' economic welfare at risk

Concentration in Canada's financial sector is already high. Further concentration could lead to a deceleration in responsible competition and innovation, which could undermine the economic interests of Canadian consumers and businesses.

Canada's financial sector is more concentrated and shows some signs of being less competitive than that of its peers, according to research from McMaster University's MPP in Digital Society Program. Key findings from the research include:

- Depending on the metric considered, there is mixed evidence on the current state of competition in Canada's financial sector.
- Canada's banking system is more concentrated than international peers, and the big six banks' market share in major product categories has remained. stable over the past decade, despite the growth of fintech challengers.
- Canadian banks consistently outperform international peers on return on equity (ROE), driven in part by highly profitable domestic personal and commercial banking.
- The proportion of bank income from non-interest sources such as transaction and investment management fees has increased over the past decade, along with the absolute level of these fees.

While concentration isn't, by itself, necessarily bad, it can be a sign of a market that isn't sufficiently contestable,[1] which has a pernicious effect on the economic welfare of consumers (which we use broadly to include business clients of

[1] There are two questions for policymakers here. The first is whether the structure of Canada's financial sector is a symptom of a lack of market contestability, which would give dominant firms the market power to indefinitely extract supracompetitive economic rents. The second is, if so, whether the rents are the price we must collectively pay for the responsible innovation we expect of Canada's financial sector. For a discussion of market power and regulation, see here.

Canada's financial institutions).[2] In markets that aren't sufficiently contestable, consumer interests are undermined. Prices for consumers are likely to remain high, if not rise, while the quality they receive is likely to stagnate, if not degrade.

Fees for financial services in Canada, which are reportedly some of the highest in the world, have been rising, but it's not clear that the quality of financial services has been rising as well. In fact, according to some surveys, the level of dissatisfaction has been consistently high for certain consumers. For example, the Canadian Federation of Independent Businesses surveys its members' attitudes towards banking. The surveys have frequently reported the lowest levels of satisfaction for Canada's largest and most profitable banks, with businesses pointing to high fees, poor customer service, and limited access to capital, among other things. Consumers of personal banking also have reported dissatisfaction with their banks. According to a survey from J.D. Power, more Canadians have been paying fees in the last year, with nearly 8 in 10 Canadians feeling like their banks could be doing more to serve them well.

The level of contestability in the financial sector is the result of policy choices that have been made by the federal government, many of them for good reason, such as promoting the stability and security of the financial sector. That's why many of these policy choices can't be undone. But new policy choices can be made to mitigate the unintended consequences of the old ones without undermining their effectiveness.[3]

We applaud the government's recent steps to make financial services in Canada more competitive and innovative with consumer-driven banking and amendments to the Canadian Payments Act. But complementary work can be done to ensure that the government's oversight of the financial sector is promoting, rather than undermining, the interests of consumers.

We recommend that the Department of Finance launch a review of responsible competition and innovation in Canada's financial sector. This review should entail:

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[2] The interest of consumers in the financial sector is to receive a complex basket of goods and services at more affordable prices and at an increasing level of quality over time. Consumer preferences are heterogeneous, and so the composition of baskets differ. For example, consider Avernas et. al's (2023) work on how the deposit business differs at large banks versus small banks.

[3] The "theory of the second best" tells us that when policy interventions, such as barriers to entry, cannot be undone and generate unintended consequences, other policy interventions can be introduced to mitigate the effects of those unintended negative consequences.

i. The establishment of a financial sector innovation and regulation council, which will work with the government to identify opportunities for government to promote more responsible innovation in Canada's financial sector and, thereby, the interests of consumers. The council should be situated under the Department of Finance and should convene the relevant firms, academics, industry associations, consumer groups, and regulatory bodies, among others.
ii. An assessment of how the mandates and related activities of Canada's regulatory bodies compare to those in other advanced economies around the world to promote responsible innovation in the financial sector. The mandates of the Office of the Superintendent of Financial Institutions, the Financial Consumer Agency of Canada, the Bank of Canada, and the Canada Deposit Insurance Corporation should be in scope at a minimum. Consideration should be given to whether to include self-regulatory organizations and provincial regulatory bodies.
iii. A final report to the Minister of Finance with recommendations on how to promote responsible innovation in Canada's financial sector and, thereby, the interests of consumers.

2. Managing the risk of fraud in emerging payments infrastructure

Canadian governments already do a lot to protect consumers in the financial sector, especially when it comes to non-financial institution payment service providers ("non-FI PSPs"):

- **The financial consumer protection framework under the Bank Act.** This includes liability protection in the event of unauthorized credit card transactions, complaint-handling requirements, transparency and disclosure requirements, and requirements that promote appropriate sales practices, among others.
- **The Retail Payment Activities Act (RPAA).** This requires payment service providers to safeguard their customers' funds, as well as manage a range of operational risks related to their business. Though the RPAA isn't consumer protection legislation, per se, it nonetheless protects consumers if, for example, their payment service provider goes insolvent. By requiring that payment service providers manage their operational risk, it also ensures that

the payment service providers on which consumers rely conduct themselves according to a minimum operational standard.

- **Debit and credit card code of conduct.** This code, the requirements of which are legally binding by way of downstream commercial contracts, does many things to protect business customers in the financial sector. It ensures the financial sector is disclosing the costs of accepting credit and debit card payments to merchants, as well as offering merchants a clear and timely dispute handling process. It also guarantees merchants retain some control over the costs of accepting debit and credit card payments. Among other things, the code also gives merchants certain rights in respect of their contracts with acquirers.
- **Competition Act.** The Competition Act protects Canadians against deceptive marketing practices, providing for both criminal and civil penalties for contraventions of these measures.
- **Consumer protection legislation in the provinces.** Some provincial legislation protects consumers from unfair business practices. For example, Ontario recently modernized its consumer protection regime by limiting when businesses can make changes to contracts without their customers' consent, giving consumers more exit options, and empowering the ministry to hold non-compliant firms accountable.

One emerging risk to which the government should pay more attention is the "epidemic of fraud" that could come to Canada from other advanced economies with real-time payment systems. According to a ACI Worldwide report on real-time payments and fraud, although Canada doesn't have an real-time payment system (end-to-end) and doesn't crack the top ten in the world for real-time payment transactions per month, Canada's fraud incidence rate is the eighth highest in the world.[4]

In Canada, where use of real-time payments is expected to keep growing, the financial sector legislative framework and supporting codes of conduct do nothing to protect consumers in the event of unauthorized fraud when certain payment instruments are being used. For example, while the Bank Act protects consumers in the event of unauthorized credit card fraud, the Bank Act does nothing in the event

[4] Identity theft and credit card fraud are on the decline, whereas confidence tricks are on the rise. Confidence tricks are when victims of fraud play are deceived into being part of the scheme. For example, they can be duped into sending a fraudster the money the fraudster is trying to steal. The money is often transferred using a real-time payment system so that the fraudster can withdraw or move the funds out of reach by the time the victim has discovered what's happened.

of an account-to-account transfer, such as an email money transfer. The RPAA also contains no such measures.

Canada should do more to manage the risk of fraud in emerging payment systems. When Payments Canada's real-time rail goes live, transaction limits are expected to rise and the instantaneous nature of the payment may challenge the financial sector's ability to detect cases of fraud in real-time. The United Kingdom has been working hard over the years to manage the emerging risk of this type of fraud. They empowered their payment system regulator to make the reimbursement of victims of fraud in certain cases mandatory, and decided to publish "authorized fraud" data, among other things. Similarly, the Australia Investment and Securities Commission published the "ePayments Code," which sets market conduct requirements and allocates liability in the event of an unauthorized electronic payment.

In respect of the real-time rail, we recommend that the government require Payments Canada to do more than it has suggested it would do in public consultations to protect consumers from fraud. In particular, the federal government should require Payments Canada to:

- Prescribe the conditions under which a transaction is considered unauthorized, rather than leaving it to the sole discretion of the RTR participants, so that all RTR participants are playing by the same rules.
- Prescribe the process by which RTR must cooperate, rather than merely establishing a duty to cooperate, which may be too ambiguous to ensure that all RTR participants are playing by the same rules
- Prescribe the formal escalation procedures that all RTR participants are expected to have, which could include the requirement to have dedicated resources to handle customer issues, as well as a process for the resolution of customer issues and the minimum requirements for what constitutes an acceptable investigation, rather than leaving it to the discretion of participants
- Prescribe a role for Payments Canada or an independent and competent authority to resolve disputes between participants in the event the policies and/or interests of participants are irreconcilable

We also recommend that, in the event it's not feasible to work with the provinces and deliver something in a timely manner, the government consider alternatives to working with the provinces to develop a harmonized approach to market conduct supervision of non-FI PSPs. The federal government could consider a code of conduct, such as Australia's ePayments Code, which federally regulated payment service providers can opt in to. Payment system rules, such as Payments Canada's, can also reference the code to make the requirements legally binding on all payment service providers who participate in the RTR.

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On behalf of Fintechs Canada, I would like to thank you again for the opportunity to provide the Department of Finance with our perspective on upholding the integrity of Canada's financial sector. We would gladly answer any questions you have about our proposals and discuss them in greater detail. We look forward to continuing to work with you and your team in an open, collaborative, and thoughtful way, as the Department of Finance is known to do by our sector.

Sincerely,

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