



# Fintechs Canada

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Competition Bureau

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Mr. Klass,

On behalf of Fintechs Canada, thank you for the opportunity to respond to the Bureau's consultation on the proposed terms of reference for its market study on competition for financing to small and medium-sized enterprises (SMEs).

Fintechs Canada serves as the collective voice for the most innovative financial technology companies. Serving millions of Canadians (including SMEs) from coast-to-coast-to-coast on a daily basis, 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 make Canada's financial sector more competitive and innovative, while also protecting its integrity, stability and security.

We believe SMEs need better access to affordable and reliable financing to hire employees, invest in technology, and expand their operations. Since SMEs account for nearly all employer businesses and close to half of Canada's economic output, barriers to financing must be identified and dealt with if Canada is to solve its productivity crisis.

Based on the experiences of our members, we believe there are two barriers to SME financing in Canada:

1. Regulatory barriers to providing financing to SMEs
2. Regulatory barriers to competition in the financial sector, which constrains access to credit for SMEs

## 1. Regulatory barriers to providing financing to SMEs

Canada's smallest businesses—sole proprietors with low-dollar working-capital needs—are effectively prohibited from accessing financing on terms they would otherwise agree to. Last year, the federal government amended the Criminal Code to lower the maximum allowable rate of interest to curb consumer lending it understood to be predatory. But it failed to adequately differentiate between the realities of personal and commercial loans for the smallest of business owners, thereby failing to exempt commercial loans below \$10,000 to Canada's smallest businesses. As a result it constricted access for entrepreneurs by fintechs who have lending models with flexible re-payment terms needed by entrepreneurs like this example below.

### **Example: A newcomer to Canada starts her business**

Consider a newcomer, who is working on building her doula business and has already worked with a few clients.

Suppose she's been asked to take on a job that will pay her \$5,000, but she doesn't have all the necessary equipment. Suppose she needs to buy birthing comfort supplies worth \$3,000 to complete the job, but doesn't have enough cash on hand, her credit card limit isn't high enough, and while she is creditworthy, the size and age of her business means a traditional bank will not offer her financing. She can't be assured that she'll get paid in full in a month or three months after completing the job, despite how clear the payment terms are in her invoice.

There are financial technology companies that endeavour to offer the doula a loan for a fixed fee and with a flexible repayment schedule based on when the money is received. Traditional lenders fail to model loans after the realities of business owners, and aren't as capable of accurately predicting default risk for those who come from relatively under-served groups.<sup>1</sup> Regulating interest for commercial loans fails to address solutions built to address the lived experience of entrepreneurs helping them grow. Under the new maximum allowable rate of

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<sup>1</sup> See [Blattner and Scott \(2021\)](#) for more.

interest, such business loans can be prohibited if the money is received and loan repaid quickly.

Based on an informal member survey we had undertaken around the time of the regulatory changes, we estimated that 50,000–60,000 loan offers received by Canadian entrepreneurs would no longer be offered over the next ten years (2024–2032) because of the failure to exempt commercial loans. These loan offers were collectively valued at around \$230 million. It is worth noting that this figure is likely underestimated, as Fintechs Canada does not represent the entirety of Canada's lending industry.

International markets, like in the UK and Australia, have shown that both broad commercial exemptions can be made and predatory lending curbed by establishing lender liability to verify the commercial purpose of a loan. In such markets, lenders must conduct reasonable inquiry to avoid violating regulation and exposing themselves to substantial legal liability. In practice, this requires lenders to simply review and verify the existence of a business and a potential borrower's business-related income history. In the few cases where lenders have not done this, courts have forced lenders to forgive entire debts because they failed to meet their obligations under the law.

The current framework for the maximum allowable rate of interest is restricting the market for commercial credit. When the smallest businesses, such as sole proprietors, can't access small, cash-flow-matched loans, projects stall, hiring is deferred, and productivity suffers.

## **2. Regulatory barriers to competition in the financial sector**

According to the C.D. Howe Institute, the financial sector's contribution to Canada's overall productivity has been "underwhelming." The financial sector is not just a vault for our money; it's also a brain that decides how capital is allocated across the whole economy. When the financial sector isn't fostering economic dynamism, then neither is the economy:

- Financial sector regulators don't need to think about promoting competition. Unlike some of our international peers, Canada's federal financial regulators do not have an explicit mandate to promote competition.

In the United Kingdom, competition is a core principle in financial sector oversight and an explicit objective of UK financial sector regulators.

Australia's prudential regulator and its central bank also both have explicit references to maintaining competition in their mandates. In light of Canada's heavily concentrated financial sector, it would benefit SMEs if financial sector regulators administered policy in a way that reduces barriers to entry and encourages diversity among financial service providers.

- Open banking is delayed, risks being limited in scope. Full open banking implementation will enable ongoing, machine-readable access to consented SME transaction data. With near-real-time cash-flow signals, lenders can assess creditworthiness more accurately than with lagged bureau files, supporting more approvals at a given risk level and sharper competition on price and non-price terms. But the future of open banking in Canada is uncertain in that the second piece of the framework has yet to be tabled. Key questions, such as the extent to which SMEs' data will be in scope and how soon, remain open.
- Not enough (innovative) bank entry. Anecdotal accounts of the process to get a bank license (and then maintain one) suggest that the approach of Canada's prudential regulator may be disadvantageous to smaller and more novel companies. But this approach—biased towards advantaging the same large, incumbent players Canadians are already familiar with—is unlikely to materially improve the state of competition in the financial sector.

In part, Canada's gaps for SME financing reflect financial sector policy choices. If financial sector regulators are tasked to weigh competitive effects of their work, open banking is fully implemented, and the process to obtain a bank charter is modernized for entry of new and innovative companies, then the market for SME credit will be more competitive and responsive to the needs of SMEs. Only after promoting more competition in the financial sector will the financial sector start pulling its weight to boost Canada's productivity.

## **Recommendations**

We agree with the direction of the Competition Bureau's market study on SME financing and recommend the Bureau do the following:

1. Evaluate the impact of the \$10,000 threshold for small businesses: examine whether the new maximum allowable interest rate framework will reduce

access to credit for small-value business loans for the smallest businesses such as sole proprietorships.

2. More rigorously demonstrate the state of play for SMEs in need of financing: in addition to gathering and documenting data on small-large firm interest rate spreads, loan approval rates, average interest rates and other fees, and differences in non-price terms, consider gathering data to use econometric measures of competitive intensity to and benchmark Canada against OECD peers.
3. Catalogue an authoritative list of barriers to SME financing (e.g., the new maximum allowable rate of interest) as well as entry and exit in the financial services market and pursue solutions through supervisory powers and policy advocacy.
4. Describe how open banking can be implemented to ensure SMEs in need of financing benefit from the framework after consulting with industry and regulators to understand how to maximize the impact of open banking on SME financing.
5. Do not focus on term loans exclusively: the focus on term loans may be primary, but the Competition Bureau should also include in the scope of its study any substitutes that materially influence term-loan competition.

On behalf of Fintechs Canada, thank you in advance for considering our perspective and recommendations. We look forward to continuing to work with the Competition Bureau as it undertakes its market study. Please do not hesitate to reach out should you have any questions. We and our members would be happy to meet with you and your team to share more information.

Sincerely,

Adriana Vega

Executive Director, Fintechs Canada