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# 2017

## WORKSHOP REPORT

Highlights from the Competition Bureau's FinTech Workshop: *Driving Competition and Innovation in the Financial Services Sector*

Canada

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# WORKSHOP REPORT

## HIGHLIGHTS FROM THE COMPETITION BUREAU'S FINTECH WORKSHOP: DRIVING COMPETITION AND INNOVATION IN THE FINANCIAL SERVICES SECTOR

### INTRODUCTION

The Competition Bureau ("Bureau") held a one-day workshop to examine the intersection of competition, innovation and regulation in Canada's financial services sector on February 21, 2017. The workshop focused on the competitive forces at play and the possible impediments to growth of financial technologies ("FinTech") in Canada.

Approximately 130 participants from Canada and abroad attended the workshop, including entrepreneurs, representatives from both established and unconventional financial services organizations, domestic and international regulators, and members of the academic and legal community. More than 100 participants also attended by webcast.

The workshop featured two keynote presentations: *The Era of Disruption*, by the Honourable Dr. Kevin G. Lynch, Vice-Chair of BMO Financial Group and former Clerk of the Privy Council, and *Fintech, Competition and Innovation: Presentation to the Competition Bureau of Canada*, by Dr. Robert D. Atkinson, President and Founder of the Information Technology and Innovation Foundation ("ITIF") and one of North America's top thinkers on innovation economics. Panellists included leaders from various segments of the financial services sector.

The workshop agenda and speaker slide presentations are available on the Bureau's FinTech web portal.

This paper is a summary of the presentations and discussions that took place at the workshop "*Driving competition and innovation in the financial services sector*." The opinions are those of the panelists and participants and do not necessarily reflect the views of the Bureau or the Commissioner.

## CONTEXT

Like many industries, the financial services sector is evolving quickly in an increasingly digital marketplace. As the ITIF noted in its October 2016 report, FinTech innovations "are poised to radically improve" how both consumers and businesses manage their money, from transferring funds and making payments, to saving, investing and borrowing. More importantly, the report emphasizes that achieving those benefits "will require policymakers to actively support FinTech transformation."

*"Our ultimate goal is to provide guidance for policy makers on how best to nurture an environment that allows Canada's FinTech companies to innovate, grow and compete globally." – Commissioner of Competition's introductory remarks*.

To realize the competitive benefits that FinTech innovation can offer, financial sector policies and regulations need to keep pace. In May 2016, the Bureau launched a market study in this sector (the "FinTech Study") to consider the competitive impact that FinTech is having on the financial services industry, the possible barriers to entry faced by new companies, and whether there is a need for regulatory reform to promote greater competition while maintaining consumer confidence in the sector.

The FinTech Study is focussed on technology-led innovations that affect the way that Canadian consumers and businesses commonly seek out and use financial products and services in three categories: lending, payments and financial advice.

Building on the themes that have emerged since the launch of the FinTech Study, the workshop created an opportunity for the Bureau to further engage with FinTech stakeholders to deepen our understanding of this evolving marketplace. It also provided a way to advance the conversation between industry and regulating entities and for stakeholders to exchange ideas, build on past experiences and, in doing so, shape the future of competition and innovation in Canada's financial services industry.

### CANADA'S INNOVATION SCORECARD

We heard that Canada lags behind many of our international counterparts in terms of innovation, particularly in the private sector. In his presentation, Dr. Lynch noted that, internationally, Canada ranks 22nd on innovation and 22nd on business spending in the ratio of research and development to gross domestic product. Despite pockets of global excellence and some best-in-class research strengths in universities, we do not place in the top 15 innovation ecosystems in the world, and only four Canadian universities rank in the world's top 100 research universities.

Greater innovation in all sectors of the economy, including in financial services, is needed to boost productivity and growth and to improve Canadian competitiveness.

So, why the lag?

According to a recent Ernst & Young FinTech adoption survey, only 8% of Canadians use alternatives to incumbent financial services. The number one reason highlighted in the survey report is lack of awareness of the alternatives.

Discussion at the workshop suggested that FinTech adoption is slow because the current system is not broken. Many

Canadians have a strong and trusting relationship with their banks, and existing firms work hard to identify and satisfy existing customers.

Dr. Atkinson provided some insight, noting in his presentation that the pace of change in the FinTech industry is glacial because adoption of new technology in banking requires coordinated change. Incumbent banks have relatively weak incentives to move beyond the status quo, which in part explains why most maintain multiple types of legacy and dedicated software, rather than replacing them with integrated, interoperable systems.

Dr. Lynch noted two impediments to FinTech growth: consumer banking behaviours and the challenge of achieving scale in small domestic markets like Canada – underscoring the need to promote global growth.

Dr. Lynch also highlighted the key drivers to global growth as being trade liberalization and technological change with FinTech as an example of how technology holds the promise to dramatically improve labour productivity. While sovereignty remains within borders, commerce does not. Canada must continue to value and engage in trade. As Dr. Lynch noted, Canadian banks are already exporting select expertise internationally.

## THE IMPACT OF TECHNOLOGY-LED INNOVATION – THE FINTECH PROMISE

### “DISRUPTION” IS THE NEW BUSINESS MODEL

The two “competing nodes” of the FinTech spectrum were described as, on the one hand, incumbents with legacy systems, and, on the other, new entrants who are actually technology companies building software that is disrupting business models all over the world. Many are leveraging artificial intelligence (“AI”) predictive analysis and big data, and some are using partnerships to add efficiency and value to their customers’ experience.

What is important, we heard, is not the entity or the underlying technology that it uses, but the activity, economic function or purpose that the technology serves (*e.g.*, investment advice, lending, insurance, payments). The “disruption” emerges from the way such services can be provided.

> “It will disintermediate functions not firms. It will intermediate some of the financially excluded. It will increase competition. It will test regulators.”
>
> (Dr. Kevin G. Lynch)

The consensus at the workshop was that the disruptive technologies and innovative business models that are emerging in the financial services sector have the power to challenge the *status quo* if they are given the opportunity to enter and compete.

### THE FINTECH PROMISE

We heard about a confluence of reinforcing factors at play that are creating an opportunity for innovation in the financial services market: incumbents updating their legacy systems, customers changing their preferences and expectations, and new players seizing opportunities following the 2008 global financial crisis. While the application of technology to financial services is not new, entrants in this space are developing new customer experiences and exploiting changing consumer expectations (*e.g.*, simplicity in investing).

Regardless of the definitions and drivers, participants agreed that FinTech has the potential to deliver real benefits to consumers and markets, including increased choice, efficiency gains, operational resiliency (*e.g.*, from replacing legacy systems), lower costs, and increased pricing transparency. However, we heard that realizing that promise requires balance, scale (capital and the ability to export expertise) and access to data and infrastructure (*e.g.*, open banking).

On the other hand, FinTech also brings new risks in terms of consumer protection, cyber-security, and systemic risks (given the scalability of the underlying platforms) that must be considered and mitigated.

> "Innovation in financial services is a huge opportunity to improve the financial system by leveraging the technology and new business models to increase access to financial services, increase the efficiency of the services that are being provided by replacing legacy systems, and perhaps creating a little bit more competition and more contestability of markets in the services, so that businesses and households can benefit from that. (...) With great opportunity comes the responsibility to manage the risks that are associated with new technologies and new services that are being provided so that they indeed do reap the benefits for households and for businesses."
>
> (Carolyn A. Wilkins)

### DIFFERENTIATION AND SEGMENTATION

We heard that FinTech firms have an opportunity to differentiate themselves to better meet customer needs; particularly as millennials enter the work force, earn more income and find themselves frustrated by the current customer experience.

One theory proposed is that innovation happens at the intersection where the greatest sources of consumer friction meet the largest profit pools. With systems that are more flexible and lower cost, FinTech firms target those segments of the consumer base that they can peel away from incumbent institutions, allowing FinTech firms to become more specific niche players and offering, in some cases, non-financial differentiation dimensions (*e.g.*, coaching consumers in good financial decision making).

## BARRIERS AND CHALLENGES – WHY FINTECHS ARE NOT REALIZING THEIR PROMISE

Challenges around consumer complacency and trust, access to data and infrastructure, scale, and a complex and dated regulatory environment were identified as some of the biggest issues facing FinTech firms today.

### COMPLACENCY AND LACK OF TRUST

We heard from participants that mistrust and complacency are impediments to growth.

According to Ernst & Young, despite the availability of alternatives, only 31% of Canadians trust transparency in pricing by the "big five banks", and nearly 71% of Canadians still choose one of the "big five banks" as their primary financial institution.

Consumer complacency or inertia was noted as the reason for slow FinTech uptake in Canada. But it's not just consumers. It was suggested that businesses are comfortable being part of a resource rich country close to the United States ("US"), and may not feel the need to do things differently. This was referred to as the "plateau effect".

We also heard that Canadians are less savvy or mature digitally than they are financially, which may explain the slower uptake of FinTech.

### ACCESS AND SCALE

Access was a recurring theme at the workshop and has been identified throughout our consultations.

A number of participants spoke about the issue of access to data and infrastructure. Access to consumer and/or transaction data from consumers has the potential to enable FinTech innovators to better understand their customers and produce better services and products, but also to better comply with various regulatory requirements that require knowledge of a client (*e.g.,* know-your-client ("KYC"), and anti-money-laundering ("AML") requirements).

Participants also raised issues around access to banking infrastructure to better provide consumers with frictionless services and improved interoperability between services. In the payment space, this means more direct access to the payments system to reduce friction in transactions (*e.g.*, by enabling faster transactions). For the most part, it also means access to core banking services that FinTech firms require, in particular when money is held in trust or in a brokerage account.

This particular challenge for FinTechs was underscored by Dr. Atkinson: start-up FinTech firms need to interact with the legacy or operating/infrastructure systems of incumbents, who may not want to allow for that interaction even if the customer consents.

Other challenges mentioned that are affecting the ability of FinTechs to bring their products to sufficient scale relate to attracting talent and obtaining capital beyond the seed stage (i.e., beyond $10 million).

### CUMULATIVE BURDEN AND UNCERTAINTY AROUND REGULATIONS

The need for appropriate and balanced regulation was not in dispute. Participants noted that new entrants, in particular, recognize the role that regulation can play in winning consumer confidence.

We heard that our Canadian regulatory framework for financial services is complex and fragmented. There are many regulators with varying mandates and perspectives (*e.g.*, consumer protection, market integrity, AML, stability and safety of the financial system and monetary policy) and there are differences in regulations across and within jurisdictions (between provinces and countries).

While perhaps individually sensible, we heard that this cumulative regulatory burden and the lack of clarity around regulations' application create an impediment for companies, consumers and investors. Furthermore, some FinTechs operate outside of the regulated space (whether they should be or not), making it difficult for regulators to monitor and identify risks.

> "For regulators, it's about balancing the gains from innovation and competition against the unknowns of resiliency to cyber-attacks and fraud, to system risks, to monetary transmission, and to consumer protection."
>
> "In theory, financial regulation should promote effective competition, ensure consumer protection and maintain systemic stability and the integrity of the monetary policy transmission mechanism. The reality is that there is a mixture: principles-based and prescription-based regulations; coordination and fragmentation across national jurisdictions; certainty and uncertainty (*e.g.,* extra-territoriality)."
>
> (Dr. Kevin G. Lynch)

### KEEPING PACE IS A REGULATORY CHALLENGE

Managing and predicting future regulatory risks is increasingly challenging in a digital and interconnected world. Specifically, we heard that operating in a digital environment with virtual currencies, anonymity of transactions/platforms, and huge amounts of data lends itself to risks and vulnerabilities that can be exploited for financial crimes, and can create significant oversight challenges (*e.g.*, privacy implications, record keeping issues).

There was also acknowledgment that the current regulatory framework is entity-based, prescriptive, and not written to take into account changing technology. For example, FinTech innovations do not fit neatly with securities requirements designed around face-to face-interactions.

While the objectives may be sound, prescriptive regulation can be difficult to implement in a digital space. If too rigid, such regulation reduces businesses' ability to be nimble and responsive to market demand and reduces regulators' flexibility to adapt to the changing marketplace. Examples cited during discussions included requirements with respect to KYC, AML, ID verification, cost of borrowing, use of fax for some tasks, and wet signatures, which are maladapted to digital-only service providers.

Some participants identified a disconnect between the enthusiasm of regulatory bodies to embrace change and the rigidity of staff tasked with the day-to-day enforcement.

Another potential barrier raised was the reliance on current standards by incumbents who may be reluctant to agree to changes in standards that would mean the development of substitutes for their services.

## OPPORTUNITIES AND SOLUTIONS – WHAT CAN BE DONE TO HELP FINTECHS REALIZE THEIR PROMISE?

Flowing from the barriers and challenges raised by the workshop participants, a number of ideas and potential opportunities to increase innovation and competition in Canada's FinTech sector were put forward.

### LEVERAGE CANADIAN "BRAND" AND UNIQUENESS

While Canada was seen as not doing as well as we could on the innovation front, our Canadian "brand" and reputation in terms of our stable and robust financial services framework is strong both domestically and globally. Notably, many agreed that Canada has a comparative advantage in FinTech innovation because of our concentrated and highly robust banking system and leading talent in the "tech" sector, particularly in the Waterloo-Toronto corridor. Canada is also home to the world's only quantum computing software.

The global financial crisis also demonstrated Canada's capacity to be a leader. We heard that Canada could leverage its strong brand, reputation and uniqueness both domestically and globally by creating hubs and clusters in FinTech niches where Canada can "win" in the global market, for example in AI and quantum computing.

### CONSIDERATIONS FOR REGULATORS AND POLICY MAKERS

*BALANCED, DYNAMIC AND ENABLING REGULATORY APPROACH*

Regulators have an important role in setting the pace and enabling innovation in the financial services sector. They must strive to narrow the inevitable regulatory lag as much as possible with as much foresight as possible. This means fostering a flexible and dynamic regulatory environment that allows for current and future FinTech innovations to develop and grow.

We heard that this can be done with a regulatory approach that is balanced, principles- and function-based, technology neutral, focused on the appropriate risks, harmonized, and "lighter".

> "What we should focus on is not the regulations being the same, but the protections being more or less the same."
> (Dr. Robert D. Atkinson)

The right regulatory approach is about striking a balance between enabling the benefits that FinTech innovation has to offer (like efficiency and optionality) and the expected and appropriate resiliency in financial security/soundness and consumer protection. We heard that some FinTechs welcome more regulation to increase trust as well as to support growth and achieving scale. It is about getting the principles right, which go beyond specific products, entities or institutions, and the need to be inclusive of industry and consumer needs.

And while appropriate regulation may be necessary, not all FinTech players may require the same level of regulation. Further, greater regulatory harmonization domestically and internationally is more "enabling". We need to consider what is happening in other jurisdictions (broader view), and not just what we need to restrict within our borders. The point of regulation, we heard, is to adjust behaviour. Fewer regulations could be more conducive to advancing innovation (or can at least assure greater alignment).

### *ENABLING COMPETITION AND INNOVATION*

We heard that it is not sufficient for regulators to do no harm – they need to be effectively engaging and creating a supportive and responsible environment for innovation.

Efforts such as the Ontario Securities Commission's ("OSC") LaunchPad and the Bank of Canada's ("BoC") Project Jasper were cited as potential means by which regulators can provide such an environment. The OSC LaunchPad provides industry with support and guidance on the applicable regulatory framework and how it applies to their business model, while the BoC is exploring the potential applications of distributed ledger technology through Project Jasper.

We also heard that jurisdictions where competition has been added to the regulator's mandate have been aggressive in their pursuit of FinTech.

> "… nobody specifically sees their job as driving systemic transformation and innovation. Competition authorities look at competition, but competition is not an end, it's a means. Authorities need to look at their role as "enablers" in supporting transformational innovation."
>
> (Dr. Robert D. Atkinson)

### *EMBRACE OPEN BANKING / OPEN ACCESS*

We heard a lot about the potential benefits of implementing an open banking system, with reference to the United Kingdom's ("UK") experience.

In the UK's Competition and Markets Authority ("CMA") 2016 report "Making Banks Work Harder For You", the CMA concluded that older and larger banks don't have to compete hard enough for customers' business. Smaller and newer banks find it difficult to grow, meaning many people are paying more than they should and are not benefiting from new services or from switching providers. To tackle the problem, the CMA is implementing a series of wide-reaching reforms, including a requirement for banks to implement open banking by early 2018 which has the potential to make competition work better. Open banking enables consumers and small businesses to take more control of their funds by sharing their data with third parties. Application program interface ("API") technology will allow third parties to access customers' data and compare the available alternative financial services, potentially even switching them to a new provider. Consumers will also be able to manage and move funds between different accounts with different banks through a single provider. Regulation will help these third parties earn consumers' trust.

The reforms are part of a broader journey towards implementing open banking that include the European Union's revised Payment Services Directive (PSD2), and will recognize non-banks as legitimate players in the marketplace, who must comply with regulations that are more appropriate to their business.

While the UK has made it considerably easier to switch, there is still not a significant uptake in consumers switching financial service providers. So, while open banking provides a fair opportunity to access the data and infrastructure needed to compete with incumbents, FinTechs still need to develop the value proposition for consumers to use their services.

According to Dr. Atkinson, while there do remain some challenges to overcome, open banking is fundamentally a more efficient, lower cost, more globalized and more consumer-friendly model.

### *STAKEHOLDER ENGAGEMENT AND GUIDANCE*

We heard about the need and opportunity for Government, specifically financial oversight regulators, to publicly clarify whether they see particular systemic risk with FinTech innovation in Canada. Such guidance could assuage the concerns of investors making them more willing to invest in new entrants.

It was also suggested that Canada model other jurisdictions that are educating and improving clarity around regulations, for example, via regulatory concierge services, which provide a point of contact between regulators and FinTechs and help new entrants navigate the regulatory framework.

## COLLABORATION IS KEY

Keeping pace with change is challenging for both the private and the public sectors, but collaboration and partnerships are emerging to manage and overcome these challenges.

> "I would just like to underscore the importance of collaboration, not only among authorities in Canada and internationally, but also with the private sector. (...) One of the things that we learned ... is the importance to really understand the business models and the technologies from both sides so that when we do move forward we move forward together and in the right direction."
>
> (Carolyn A. Wilkins)

### *PARTNERSHIPS AMONGST FINTECHS*

To paraphrase the great economist Sir John Hicks: Canadian banks have led a "quiet life" for a long time, with little disruption. Banking profits have been steady and trust has been high. But banks are quickly realizing they must adapt to remain competitive in these rapidly changing times.

Dr. Atkinson noted that incumbents might thrive if they take innovation expert Clayton Christensen's words to heart: "If a company is going to cannibalize your business, you'll almost always be better off if that company is your own, instead of a competitor." We heard that collaboration between start-ups and established institutions can lead to excellent outcomes for both: be it bridging a service gap or providing nimbleness and creativity to accelerate the evolution of existing services (*e.g.*, updating their legacy systems). Start-ups view this partnership as a way to access incumbent legacy infrastructure and platform technology and achieve scale quicker.

Many also see this type of partnership as a way for start-ups to exploit the incumbents' established, trusted and regulated brands, in order to offer more comfort to the end user (i.e., a trusted and regulatory seal of approval).

### *COLLABORATION BETWEEN* REGULATORS *AND INDUSTRY*

Regulators are still learning about the impact of FinTech on the market, which underscores the importance for policy and rule makers to continue to engage and exchange ideas with all stakeholders before issuing new policy.

There was no dispute that collaboration between regulators and industry is needed to get policy and regulation right and to move innovation forward.

> "I think the big theme that you're going to hear about going forward … is partnership. (…) And it's partnership between regulators, incumbents and start-ups on the issues that they are facing (...) The more we can collaborate on the principles… the better we are all going to be as a result of that."
>
> (Michael Katchen)

The key is to ensure a diversity of stakeholder input and perspectives. The experience of the US Federal Reserve in bringing together representatives from a number of segments of the industry (small, medium and large financial institutions, consumers, and merchants) and deciding collectively on ways to improve the US payments system exemplifies the importance of the public and private sectors working together toward a specific goal (or "mission"), with FinTech innovators involved in the policymaking process in a real way.

Participants discussed various regulatory responses. For example, we heard that jurisdictions like the UK (FCA's Project Innovate), Australia, Singapore, Hong Kong, Malaysia, and the US (Project Catalyst) have tried a "lighter" regulatory framework with collaborative initiatives, such as innovation hubs and regulatory sandboxes. Innovation hubs are like dedicated teams for businesses to talk to, get help navigating regulations, and obtain registration on an exempt basis (in some cases). Sandboxes help FinTechs by allowing them to experiment and help regulators by allowing them to monitor the FinTechs, understand the unexamined barriers and watch for risks that may need to be addressed. The OSC has tried to build both concepts into the LaunchPad initiative by providing informal guidance to FinTechs at an early stage about how securities regulation applies to them, and offering flexible approaches to regulatory requirements.

We also heard about the idea of a regulatory passport as a collaborative means to promote regulatory harmonization and to facilitate the export of expertise and talent. A passporting system could mean that once a FinTech is established in one country it can more quickly operate in another.

Lastly, we heard that the UK and Singapore are leaders in the FinTech space because their governments have taken roles not just in leading good policy, but also in convening and fostering dialogue in the FinTech community (*e.g.*, creation of Innovation Finance in the UK and MAS' FinTech Festival in Singapore).

### *COLLABORATION BETWEEN REGULATORS*

Canadian regulators are paying attention: everyone at the table is engaged and willing to work together to create a regulatory framework that is both sound and innovative.

The need for continued collaboration between regulators to harmonize and provide clarity in the oversight of the financial services sector was highlighted, as well as the need for more deliberate and regular checkpoints.

To the extent that we want to become a leader in this sector, we heard that Canada could learn from the experiences in Australia, Hong Kong and the US. Through a more national FinTech strategy or champion within the consortium of financial services regulators, Canada could better realize its FinTech potential.

## LOOKING AHEAD

The workshop provided an opportunity for the Bureau to gather valuable insight from key stakeholders on emerging issues and possible solutions to help competition and innovation thrive in the FinTech sector.

The results of the discussions will inform the FinTech Study and its final recommendations on driving competition and innovation in the financial services sector, which will be published by the end of 2017.