Written Submission for the Pre-Budget Consultation in Advance of the 2023 Federal Budget

By:

PAYTECHS OF CANADA

Recommendations

Recommendation 1: That the government lower the cost of doing business for Canadians by introducing new measures that incentivize competition and innovation in the financial markets.

Recommendation 2: That the government protect the integrity of Canada's financial system by continuing to make progress on payments modernization and open banking.

About Us

Paytechs of Canada is a Canadian not-for-profit association that provides a harmonized voice for technology companies that move money. Our membership includes Canadian fintech market leaders, global fintech companies, payment networks, financial institutions, and fintech start-ups and scale-ups that are defining the future of financial services.

Fintechs are companies that use technology to deliver financial services to Canadians, helping them meet their financial objectives. Such organizations are fundamental to the vibrancy of the Canadian economy – the better they're able to serve Canadians, the more efficiently Canadians can meet their financial objectives. Today, one in four (24%) of Canadians are actively using non-bank financial technology apps and there is widespread agreement that these platforms are easy to use (91%) and help them save time and money (73%). The biggest fintech vertical is payments technology companies, with the Bank of Canada estimating that there are 2,000 payment technology companies in Canada.

While fintech is on the rise in Canada, outdated policy and infrastructure remain a major hurdle to the continued success of fintech, as well as to the stability and security of Canada's financial sector, hurting Canadian consumers, businesses, and the broader economy.

Paytechs of Canada and its members came together to help change that.

How Canada's financial sector is doing

Canada's financial sector is not robust.

While Canada's financial sector survived the financial crisis more than a decade ago, recent events have exposed a major vulnerability. When Rogers went down over a month ago, it also took down Interac's payment system—and with it the only way to use or accept a debit card payment in Canada, or an email money transfer. For people without access to cash or a usable credit card, such as low-income Canadians, buying groceries, gas, medicine, and other essentials was impossible.

In Canada's financial sector, the level of concentration is a major risk. In addition to controlling 90 percent of the country's banking assets, Canada's five big banks control how money moves. Nearly all the money movement in this country happens between big banks via the networks of Visa, Interac, Mastercard, and Payments Canada. Big banks sit in the middle, processing payments for the majority of other financial institutions.

Canada's financial sector is not robust. Systems that are robust can withstand pressure without falling apart. This is why redundancy—or spreading your eggs across multiple baskets—is conventional wisdom. But as recent events have shown, Canada's financial sector has all its eggs in one basket.

Canadian consumers and businesses need better financial services and relief from fees amidst increases in the cost of living.

Businesses have long complained about the high costs of doing business in Canada. The Bank of Canada and EY estimate that sending and accepting payments in Canada costs Canadians anywhere between $89 and $107 billion every five years in transaction and other administrative fees.

Consumers need relief, too. A survey from a few years ago found that Canadians are paying thousands of dollars in banking fees over the course of their lives, in some cases exceeding the amount of interest they're generating in their savings accounts. According to research we commissioned from McMaster University on Canada's banking sector, the share of income from banking and other administrative fees has increased over the past decade, along with the absolute level of such fees.

What's more, according to the C.D. Howe Institute, the contribution of financial services to the productivity growth of Canada has been "underwhelming." Productivity growth in Canada has been lagging relative to the level of productivity growth in our OECD peer countries. The financial sector is Canada's conduit for attracting capital and then allocating it. But businesses report that access to capital is a barrier to their growth. This is especially true of businesses in more marginalized spaces of Canada's economy.

How Canadians feel

This all comes at a cost to Canadians —- and they are noticing.

According to a landmark survey conducted by Pollara Strategic Insights and commissioned by Paytechs of Canada and FDATA North America, **more than half of Canadians (52%) and small business owners (51%) feel stress when interacting with Canada's financial services sector**.

This trend disproportionately affects marginalized communities. For example, immigrant small business owners are more likely to be stressed by their interactions with the sector (58%) while more than half of women (55%) share that sentiment. Students (70%), Atlantic residents (63%), and Canadians aged 18-34 (69%) are also particularly impacted.

But Canadians also believe things can be improved. According to Pollara, over two thirds of Canadians believe that more competition in the financial services sector would lead to a greater choice in products (70%) and lower financial services fees (67%).

And Canadians also recognize that fintechs are an attractive alternative to traditional financial institutions. More than one third of Canadians have used non-bank fintech apps. These Canadians overwhelmingly agree that such apps are easy to use (91%), have lower fees (82%), and help them save money (73%). Overall, fintechs empower Canadians to participate in the digital economy, helping them meet their financial goals.

How Canada should respond

Make our financial sector more robust.

The federal government has launched several initiatives that will manage a range of risks in Canada's financial sector. This includes the appointment of an open banking lead and the introduction of the Retail Payment Activities Act. But a big risk is being left unmanaged: concentration risk—or putting too many eggs in too few baskets.

Canada still doesn't have a real-time payments system that fintechs, credit unions, and smaller banks can access, while other advanced economies – including the United Kingdom and Australia – do. According to a recent investigative report from the Logic, one reason for the delay is regulatory capture by incumbents. The delay means Canadians have no alternatives in the event major payment networks go down, such as when Interac's payment system went down as a result of the Rogers outage.

What's more, until the federal government completes its work on open banking, the risk that Canadian consumers and businesses are sharing their financial information inefficiently and unsafely will remain. Given that millions of Canadians are already sharing their data in such ways, it's only a matter of time before risk materializes here, too. This could include non-trivial data breaches and monetary losses for consumers and businesses.

More involved and proactive oversight of Canada's financial sector will help to make sure that risks are being effectively managed. As a recent report from a CIGI and Bennett Jones roundtable of experts notes, "Canada is the only major economy delegating the governance and operation of its core payments system to an arm's-length entity, with only indirect or exceptional government intervention, such as through ministerial approval of bylaws or a directive power (never used to date)."

Give consumers and businesses better financial services and relief from fees to make living more affordable.

Canada should complete payments modernization and implement all phases of "open banking." Payments modernization involves a range of initiatives, but the two that will promote competition is building a real-time payment system and giving banks, credit unions, and fintechs access to it. By giving regulated participants in the financial sector equal access to payment systems, competition will drive down fees for consumers and businesses. The same can be said about open banking, which will let Canadians efficiently and securely share their financial information with organizations of their choosing to power new and improved financial services, helping them better meet their financial goals.

These initiatives are supported by independent experts. Research from McMaster University on the financial sector argues that Canadian policymakers could do these things, among others, to promote more competition and innovation in financial services, which would make life more affordable for Canadians. Similarly, a market study on technology-led innovation in the financial sector from the Competition Bureau argued the same, noting that "there are many barriers to entry and growth facing new and incumbent firms alike."

More competition would also help Canadians in more indirect ways. In the U.K, where fintechs have access to payment systems and a comprehensive open banking regime, capital and talent are pouring in. In the first half of 2021 alone, British fintechs attracted £5.7 billion in funding — more than the total amount raised in 2020. About 42% of the country's industry consisted of people who came from other countries. That included Canadian capital and talent, too — capital and talent that we could be fostering right here, at home.

Recommendations

A modern regulatory environment is the one thing that can safeguard Canada's financial landscape and enable our fintech industry to reach its full potential. While fintechs rely on a variety of macroeconomic factors for their success, a modern and supportive regulatory environment will do the most to help break down the barriers preventing our industry — and our country — from being more competitive, robust, and secure.

Recommendation 1: That the government lower the cost of doing business for Canadians by introducing new measures that incentivize competition and innovation in the financial markets.

➔ Amend the *Canadian Payments Act* to make federally regulated payment service providers eligible for membership in Payments Canada and to access Payment Canada's future real-time retail payment system.

➔ After implementing the first phase of the Open Banking Advisory Committee's Report, make sure that Canada's open banking system also covers consumer and business-directed payments.

- ➔ Commit to doing a comprehensive review of payment system governance to ensure the needs of consumers and businesses are being met.

Recommendation 2: That the government protect the integrity of Canada's financial system by continuing to make progress on payments modernization and open banking.

- ➔ Once Canada's Open Banking Lead has completed the first phase of their work, establish a formal governance entity to oversee the open banking system, help to resolve disputes between participants, and ensure Canadians have recourse in the event things go wrong

- ➔ Ensure that Payments Canada launches Canada's new real-time payments system with features that provide Canadians with trust in the financial system, such as recourse for consumers and businesses in the event things go wrong

- ➔ Table a plan to update Canada's financial sector legislative framework to effectively oversee and manage the risks of cryptocurrency and stablecoins, while also supporting the economic opportunities they present