

STRENGTHENING COMPETITION IN CANADA'S FINANCIAL SECTOR

A Blueprint for Innovation and
Affordability in Financial Services

A joint submission to the Government of Canada in
partnership with Fintechs Canada and the
Canadian Anti-Monopoly Project (CAMP)

CANADIAN
ANTI-MONOPOLY PROJECT

 Fintechs Canada

Introduction

As the foundation of the Canadian economy, there are few sectors more important than the financial sector. Canadians depend on their banking system to protect their hard-earned savings, access the credit they need to purchase a home, and to support the businesses that make up our economy.

In order to be well-served by their financial sector, Canadians depend on competition. Competition is the force that drives down prices, improves quality and develops new and innovative services to meet the needs of Canadians. While Canada's sound financial sector is a point of international pride, there is work to be done on the state of competition in that sector. Canada's financial sector is dominated by a handful of large players, and has high barriers to entry to those who wish to offer alternatives to Canadians.



As affordability continues to be top of mind for Canadians, now is the time to make important investments in the future of competition in our financial sector. Dispelling ourselves of the myth that there is always a trade-off between financial sector stability and competition, Canada can put its expert regulatory community to work to give Canadians a more competitive financial sector for its citizens.

Accordingly, Fintechs Canada and the Canadian Anti-Monopoly Project (CAMP) welcome the Department of Finance's consultation on strengthening competition in the financial sector. Recognizing that policy makers and regulators must achieve several goals in the stewardship of the financial sector, there is a responsible path towards introducing more competition to the benefit of Canadians.

To strengthen competition in the financial sector, the Department of Finance should:

- ✓ Create competition mandates for federal financial sector regulators, such as OSFI in its role as prudential overseer, FCAC as consumer watchdog, and the Bank of Canada in its role as payment system overseer
- ✓ Explore the creation of a college of regulators to promote more harmonization and coordination between different regulatory agencies
- ✓ Modernize Canada's approach to granting bank licenses to support a more diverse marketplace
- ✓ Expand access to and promote fair and level pricing of critical payments infrastructure
- ✓ Give Canadians the right to control their financial data
- ✓ Where the Minister of Finance decides to approve a financial sector merger, public interest considerations should not override any lessening of competition or rivalry determined by the Competition Bureau
- ✓ Make public the conclusions of the Minister's assessment of the public interest impacts of any financial sector mergers, which should include measures to be taken to address the anticompetitive effects identified by the Competition Bureau
- ✓ The government regularly review the state of competition in the financial sector, with the analysis to be done by the Competition Bureau, which would provide public recommendations to the Minister of Finance for approval and implementation, based on advice from Department of Finance officials
- ✓ The Minister of Finance table a response to the Competition Bureau's recommendations, explaining whether and why the government will take action (or not) in the way it's decided to

A competitive financial sector is key to improving affordability and boosting productivity

Canada has a competition problem in financial services

Few things have stood the test of time as well as the economic benefits of competition.

Competition is the beneficial rivalry that moves much of our economy forward. Though conflictual in nature, the products of fair and open competition are innovative services, higher quality, lower prices and a balanced relationship between businesses and the customers they serve. The past decade has seen the reawakening of the role of competition in fostering healthy and dynamic economies in Canada and in [our partners abroad](#).

Financial services should not be an exception to this reawakening. The range and quality of services available, as well as the cost to access those services, depends on how competitive the market for financial services is in Canada. Competition is also a positive driver of one of the financial sector's most important tasks: the efficient allocation of capital in our economy, spurring growth and productivity gains in other sectors. In this way, competition in the financial services sector is a core component of competition in the broader economy.

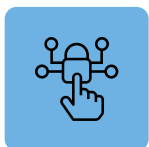


Canada's financial service sector falls short on a number of measures of competition, especially when compared to international peers:



Higher Fees

Canadians pay higher fees to access financial services.¹ Compared to the biggest banks in the United Kingdom and Australia, Canada's big five banks—TD, RBC, BMO, CIBC, and Scotiabank—[charge more and higher account fees, overdraft fees, and NSF fees](#). Fee-related income, as a proportion of overall income and in absolute terms, [has gone up over the past several years](#).



Less Access

Canadians have less access to financing. While demand for loans from Canada's small business community has been on the rise, [credit conditions have been tightening](#). According to a survey from the Canadian Federation of Independent Business, businesses reporting a need for financing [increased from 35 to 58 percent from 2012 to 2022](#). Meanwhile, the ratio of loans being given to small businesses relative to large businesses from Canada's financial sector [hit its lowest point in recent years, with the interest rate spread between small and large businesses significantly higher in Canada than in many OECD countries](#).



Less Productive

Canadians have a less productive financial sector. Financial services contribution to productivity is underwhelming. Canada's overall productivity has been falling over the past 20 years, [lagging behind Australia's, the United States', and the United Kingdom's](#). That pattern plays out in our financial sector as well: over the past 20 years, the contribution of Canada's financial sector to overall productivity also [lagged behind Australia's, the United States', and the United Kingdom's](#).

Canada's expert regulators have made note of the state of competition in Canada's financial sector. According to the Competition Bureau, Canada's financial sector is concentrated, at risk of anti-competitive coordinated behaviour by incumbents, and [has several barriers to entry that limit competition from new entrants](#).

The current state lays out the opportunity for creating a financial sector that better serves Canadians. Promoting competition in the financial sector can lead to lower fees, increased access to financing, and a higher contribution of financial services to overall productivity, spurring economic growth. In so doing, Canada should aim not just to meet but to exceed its global counterparts.

¹ Banks collect revenue from either interest or non-interest sources of income. Interest sources of income are the difference between the interest received on a loan and the interest paid on a source of funding, such as a customer's banking deposits. Non-interest sources of income are fees, such as account fees, payment processing costs, FX fees, overdraft fees, and NSF fees.

No inherent trade-off between competition and stability

False is the idea that there is always a trade-off between financial sector stability and competition. Of course, there can be such a trade-off. While a financial sector with completely free entry and exit may be more competitive, it may also be more risk-taking, increasing the risk of financial crises. [But the same can be true of a financial sector without free entry and exit](#): when competition is suppressed and banks' profits are inflated, the financial sector can become less stable if banks take more risk with those profits.

The major reason that financial crises have not materialized in Canada is Canada's approach to supervising financial institutions, not deliberate choices by the government to suppress competition. Canadian financial institutions are strictly supervised by a single prudential regulator, the Office of the Superintendent of Financial Institutions (OSFI). OSFI protects and promotes the stability of the Canadian financial sector by [mandating high capital requirements, lower leverage, less securitization, the curtailment of off balance sheet vehicles, and restricting the assets that banks can purchase](#).

Over the years, the federal government has made policy choices to maintain and even increase the level of competition in Canada's financial sector without compromising the stability of the system. For example, the 1989 Canada-United States Free Trade Agreement [exempted American banks from the cap on foreign bank assets in Canada](#). The modernization

of the financial sector legislative framework in the 1980s and 1990s to replace the "four pillar" model of financial services had, as one of its motivations, [to reverse the negative effects of Canada's patchwork regulatory approach on competition and innovation](#). In the late 1990s, Paul Martin, then Minister of Finance, blocked the merger of Canada's biggest banks in a move that [would promote competition, according to the Competition Bureau at the time](#).

History shows that, in the presence of strong and effective prudential oversight, Canadian policymakers have [room to promote more competition without compromising the stability of the financial system](#).



Finance Minister Paul Martin and Secretary of State for Financial Institutions Jim Peterson, right, in Ottawa on June 25, 1999. FRED CHARTRAND/CP

Reducing barriers to competition and innovation in financial services

Canada has a clear opportunity to improve the level of competition in the financial sector. The federal government should do this by reducing unnecessary barriers to entry, as well as by allowing for the supervised entry of more diverse institutions to better serve Canadians.

As much as competition is determined by these companies developing innovative services and offering aggressive pricing, competition depends fundamentally on the opportunity for those companies to compete in the first place.

RECOMMENDATIONS

- Create competition mandates for federal financial sector regulators, such as OSFI in its role as prudential overseer, FCAC as consumer watchdog, and the Bank of Canada in its role as payment system overseer
- Explore the creation of a college of regulators to promote more harmonization and coordination between different regulatory agencies
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Create competition mandates for federal financial sector regulators

Canada's financial sector regulators are an important piece of this puzzle, and recruiting them in the service of creating a more competitive financial sector is key to the success of the project. Today, none of the federal financial sector regulators has a mandate to maintain a competitive financial sector. Though this doesn't explicitly prevent regulators from promoting competition, it discourages regulators from seriously considering the competitive effects of their decisions and acting accordingly.²

In the United Kingdom, maintaining competition is an explicit objective of regulatory oversight of the financial sector:



The Financial Conduct Authority, which is the United Kingdom's market conduct regulator of deposit-taking institutions, has a primary objective to "promote effective competition in the interests of consumers."



The Prudential Regulatory Authority, which is the United Kingdom's prudential supervisor of all deposit-taking institutions, has a secondary objective to "facilitate effective competition between firms."



The Payment System Regulator, which is the overseer of payment systems in the UK, has a mandate to "promote competition and innovation and to ensure payments systems are operated and developed in the interests of the people and businesses that use them."



The Bank of England, in its role as supervisor of certain financial market infrastructure and payment systems in the United Kingdom, has a secondary objective to "act in a way which facilitates innovation."

Other jurisdictions also have explicit references to maintaining competition in the mandates of their financial sector regulators, such as Australia's prudential regulator and its central bank, which supervises Australia's payment systems. Regulators in other jurisdictions are also proactively spearheading initiatives to jumpstart competition in their financial sectors, such as the United States' Consumer Financial Protection Bureau, which

recently announced its "open banking" rule. By giving the Office of the Superintendent of Financial Institutions, the Financial Consumer Agency of Canada, and the Bank of Canada explicit objectives to promote competition in their financial sector and payment system oversight, the federal government can recruit Canada's expert regulators to the task of increasing competition.

² For example, regulators may not see it as their duty to promote competition and, for that reason, neglect taking the competitive effects of their decisions. Though policymakers at the Department of Finance may be more inclined to do so in their policymaking, the line between policy making and policy administration is blurry, which means the more narrowly focused administrators may find themselves in a policymaking role from time to time. For example, consider the Financial Consumer Agency of Canada's ability to issue guidance on how certain market conduct requirements ought to be interpreted by the industry that is subject to them. Alternatively, regulators may wish to consider the competitive effects of their policymaking and act accordingly, but may be challenged by the industry they oversee on the basis of their mandate.

Support coordination and harmonization of financial sector oversight



While coordination and cooperation works well at the federal level and among provincial authorities, the federal-provincial nexus needs further improvement.*



*In [the IMF's recent financial system stability assessment for Canada](#)

Today, Canada has a patchwork approach to financial sector oversight for non-banks, such as fintech companies. Not only are there several financial sector regulatory agencies and crown corporations at the federal level, there are also several such entities operating at the provincial level. For a new entrant considering whether the Canadian market is worth operating and growing in, the fragmentation of Canada's market can make it difficult to achieve the scale necessary to justify entry in the first place.

To support more entry into Canada's market for financial services, the federal government should explore creating a "college of regulators" to support greater coordination and cooperation between all the relevant federal and provincial entities.

The purpose of this college, itself a legal entity, would be two-fold. First, it would work with the various regulators and industry to develop and establish a more coherent and unified approach to financial services oversight. Second, it would create a more public and accountable forum for existing regulators to better cooperate and coordinate their activity.

A more coherent and unified approach to financial services oversight would help make it more economical for new and non-traditional players to navigate and participate in the fragmented Canadian market. A public and accountable forum for regulators to better cooperate would also have the benefit of supporting the stability of the financial sector. In [the IMF's recent financial system stability assessment for Canada](#), it said while "coordination and cooperation works well at the federal level and among provincial authorities," "the federal-provincial nexus needs further improvement."

The government could even consider housing a fintech policy lead in the college. As the Competition Bureau has said in the past, this would give "[firms a one-stop resource for information and encourage greater investment in innovative businesses.](#)" The government should also consider secondments from industry to leverage knowledge it may not have access to, such as it did when it [appointed an open banking lead.](#)

Case study: lack of transparency in remittance payments

The federal government recently [outlined its plan](#) to follow in the United States' footsteps and crack down on "junk fees," but the government would be able to do more if it had a mechanism to foster more collaboration and harmonization between federal and provincial regulators.

While [the average cost of sending a remittance payment sits at 6%](#) in Canada, it's been estimated that Canadians could [save hundreds of millions of dollars every year](#) if they had access to more transparent remittances.

This lack of transparency, according to the World Bank, is "[one of the most important factors leading to high remittance prices is a lack of transparency in the market.](#)"

6%

[The average cost of sending a remittance payment sits at 6%](#) in Canada

20%

[Of Canadians knew exchange-rate mark-ups are part of the total payment cost for a cross-border transaction.](#)

Canada has no national framework or measures for promoting price transparency in payments across borders, which can make it challenging for Canadians to understand the true costs of their economic choices, suppressing their desire to shop around for the best deal. Governments around the world are working to ensure consumers better understand the costs of international payments and have taken steps to introduce transparent pricing.



The European Union has [enacted rules for intra-EU online transactions](#)



The [UK](#) and [Australia](#) have pursued increased transparency on cross-border payment fees.



The [U.S. Remittance Rule](#) was established in 2013 through Dodd-Frank, and introduced some transparency in the market.



Most recently, the EU proposed a requirement for [all payment service providers to disclose the cost of a payment in a more standardized way.](#)

The federal government has jurisdiction to require federally regulated financial institutions, such as banks, to be more transparent about their pricing of remittance payments. But for non-federally regulated financial institutions it's not so clear.

Though the Bank of Canada has recently become the regulator of payment service providers, it doesn't have the mandate to police the market conduct of payment service providers.

If there were a forum in which federal and provincial policymakers and regulators could collaborate and coordinate their activity, more could be done to promote price transparency and spur price-based competition in financial services—beyond the scope of the government's crackdown on "junk fees."

Modernize Canada's approach to granting bank licenses to support a more diverse marketplace

Canada's approach to prudential supervision is sophisticated, lauded internationally as a key contributor to the soundness of the Canadian financial sector. But as the financial sector evolves, so too must the institutions that regulate it. As the institution responsible for granting banking licenses and the ongoing prudential supervision of banks, there are few regulators more important to the future of financial sector competition than OSFI.

While incorporating the promotion of competition into the mandate of the institution is a first step, policy makers should consider how OSFI's approval processes shape the flow of new entrants into the banking sector and its effects on competition. Canadians are most familiar with large, diversified financial institutions, but financial services are evolving and coming from a diverse range of providers.

Large, diversified financial institutions serve the needs of some Canadians well, but other Canadians have more complex and specific needs that aren't met by the business models of homogenous incumbents. That homogeneity of incumbents also makes it more likely for the characteristics of oligopoly markets to take root in our financial sector, leading to the kind of coordination that Canada's Competition Bureau has highlighted. Non-traditional players bringing new business models are more likely to break with the habits of oligopoly markets and push incumbents to respond to new competitive challenges.

Accordingly, in executing its new mission to promote competition, OSFI should consider how it can maintain the same rigorous approval process while bringing a more diverse range of players into the market. An approach geared towards replicating the same kind of industry players Canadians are familiar with is unlikely to materially improve the state of competition in the financial sector. OSFI should explore how its approval process can be tailored towards the responsible inclusion of smaller players with more diverse business models, putting to work its high quality supervision in support of a more competitive financial sector.



Expand access to and promote fair pricing of shared infrastructure that supports a level playing field

Canada's payment system—[the system that cleared and settled more than \\$100 trillions in 2023, powering the Canadian economy](#)—can be a powerful tool in support of greater competition in the financial sector. Whether it's processing a customer's payment, depositing a paycheque, disbursing a loan, or

transferring funds between institutions, payments are the heart of the financial sector. A secure, reliable, and affordable way to move money is the heart of an effective and efficient financial services provider. But today, Canada's payments system is a barrier to competition, rather than an enabler thereof.

This is not a new problem. As [a task force reviewing Canada's payment system concluded in 2011](#), the payment system is “controlled by Canada's major banks, whose “interests are best served by keeping at bay new entrants to the system.” This has resulted in two challenges for new entrants and smaller players.



Restricted access to the payment system. Access to the payment system is limited to the largest financial institutions in Canada.

Small and medium-sized banks, credit unions, and fintech companies have to enter into commercial partnerships with the largest financial institutions who move money for them. This puts challengers in the disadvantaged position of having to pay their competitors in order to compete with them.



Pricing that puts everyone but the largest financial institutions at an economic disadvantage. Payment systems are funded by their users, such as financial institutions, who pay fees to use the systems. In some systems, the largest financial institutions pay less per transaction than the smallest financial institutions, which creates an unlevel playing field between the latter and the former.

This is why the federal government must modernize Canada's payment system by building a real-time payment system. This system should be owned and operated by a public-purpose organization so that the system can be accessed by banks of all sizes, as well as by credit unions and payment service providers. The price to use the system—the price per transaction—should also be the same for all participants, regardless of their size.

According to the World Bank, [Canada remains one of the only countries in the world to not have a real-time payment system](#). Such a payment system comes with many benefits:

- ✓ Cheaper payment options for businesses and for consumers³
- ✓ Fewer late fees on bills by being able to pay bills in real-time, rather than losing control over the multi-day clearing and settlement cycle
- ✓ Reducing debt by being able to access earned wages in real-time, rather than being forced to fill the gaps with predatory loans
- ✓ Real-time access to receivables so that businesses can manage cash better and avoid high-interest loans
- ✓ Increased GDP by billions of dollars by freeing up working capital⁴

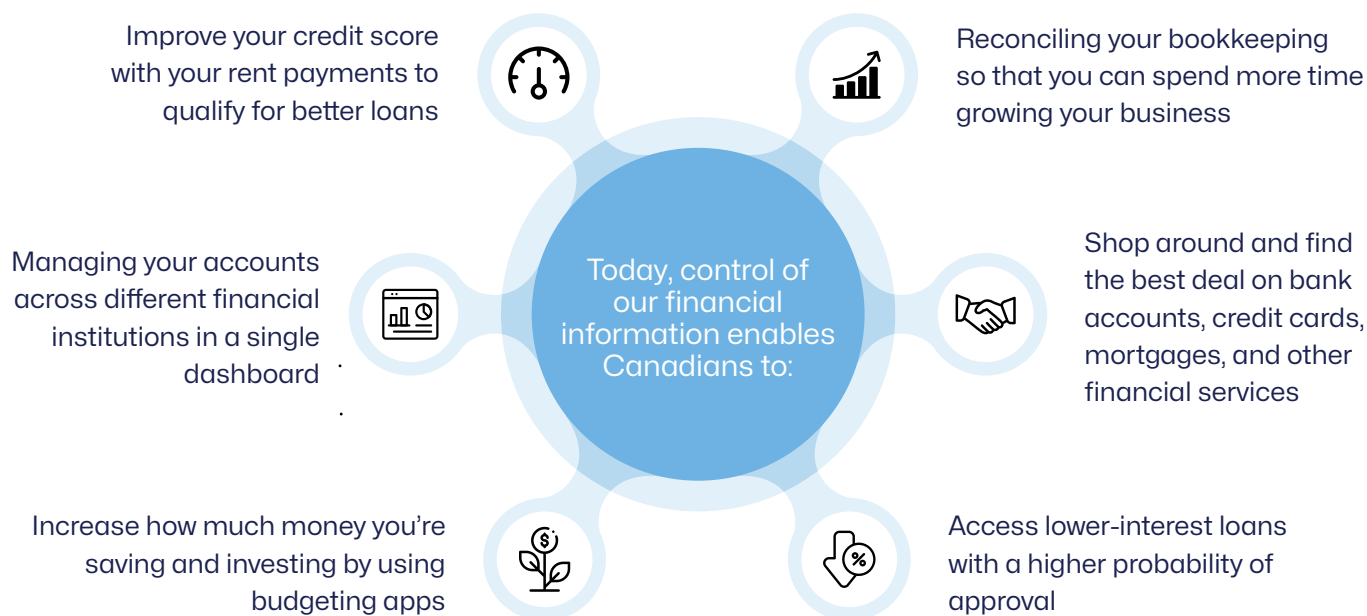
If Payments Canada is unable to work with its members to decide on a credible plan to build and deploy a real-time payment system by consensus this year, the government should give Payments Canada the power to build and deploy the system itself and compel its members to fund its building and deployment, as well as offer its use to all customers.

³ For example, when the United Kingdom modernized their payment system, Wise, a financial services company, was able to cut costs for its customers by 20 percent immediately upon being able to access the new system.

⁴ For more, see ACI Worldwide's [report on real-time payments](#) for the GDP-related effects of real-time payments around the world. Also, for more on the relationship between real-time payment systems and freeing up working capital, see the C.D. Howe Institute's [commentary on real-time payments](#).

Give Canadians the right to control their financial data

Since the advent of online banking, Canadians have amassed a treasure trove of financial information they can use to access an array of financial services.



But today most banks don't give Canadians a secure and reliable way to share financial information. According to the government's latest estimate, 9 million Canadians have been giving away their online usernames and passwords to share financial information in exchange for financial services they can't get elsewhere.

Giving Canadians a more secure and reliable way to share their financial information will support any small and medium-sized bank, credit union, or fintech company that wants to offer a customer of a bank a financial service.

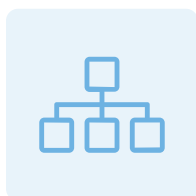
The government recently announced that it would introduce a consumer-driven banking framework in 2024, which would [give Canadians a way to securely share their financial information](#). In order for consumer-driven banking to be successful:



The government should define a broad scope of data Canadians have a right to share. At a minimum, it should mirror what [the government's own advisory committee on open banking recommended](#): chequing and savings accounts, investment accounts accessible to the consumer through their online banking portal, and lending products, such credit cards, lines of credit and mortgages.



The government should define the obligations of both data holders and data recipients. As it promised, the government should begin work on introducing tiered accreditation requirements after go-live to maximize participation from smaller companies.



The government will need to mandate a government-led entity to oversee the system. The reason for a government-led is that the entity should be independent of the industry it's overseeing to minimize the likelihood of capture. There have been reports of [an "industry utility," owned by a few of the biggest banks in Canada, positioning itself to oversee the accreditation of fintech companies](#). This would be inappropriate because it would put an industry incumbent-owned organization in a position to police the conduct of their competitors.



The government should regularly review the consumer-driven banking framework to ensure that it's consistent with the behaviour of consumers, amending it whenever necessary. It will be important that the scope of consumer-driven banking evolve over time to go beyond banking, as what the government puts in place should be the foundation or a broader consumer data right.

Strengthening oversight of mergers in the financial sector

Today the Minister has an important role in protecting and promoting competition in the financial sector: final approval for any financial sector merger or acquisition. As part of that approval the Minister is able to bring a broader public interest lens to an assessment that would be limited in the hands of the Competition Bureau to the effect on competition. The consideration of the broader public interest is an important recognition that competition is only one of the policy goals being pursued in the regulation of the financial sector.

RECOMMENDATIONS

- Where the Minister of Finance decides to approve a financial sector merger, public interest considerations should not override any lessening of competition or rivalry determined by the Competition Bureau
- Make public the conclusions of the Minister's assessment of the public interest impacts of any financial sector mergers, which should include measures to be taken to address the anticompetitive effects identified by the Competition Bureau

However, this does not mean that competition and the public interest are at odds. To the contrary, a competitive financial sector is one of the surest ways for the public interest to be served. Accordingly, an assessment of the public interest should not be the reason for the approval of a merger that otherwise harms competition. In other sectors where the government has the opportunity to override the conclusions of the Competition Bureau, such as transportation, the public interest provisions have been used to approve mergers that would reduce competition at the expense of Canadians. Paraphrasing U.S. Supreme Court Justice Brennan, an otherwise anticompetitive merger should not be saved

by some balancing of social and economic debits and credits.⁵

In approving a financial sector merger with potentially anticompetitive effects, the public interest should not be a shield for an otherwise harmful merger. If the merger is to be approved, it should be incumbent on the Minister to demonstrate to the public the measures to be taken to address the anticompetitive effects identified by the Competition Bureau. This should include how those measures will be tracked and the terms under which the measures are considered successful.

Create the data to inform future improvement

RECOMMENDATIONS

- The government regularly review the state of competition in the financial sector, with the analysis to be done by the Competition Bureau, which would provide public recommendations to the Minister of Finance for approval and implementation, based on advice from Department of Finance officials
- The Minister of Finance table a response to the Competition Bureau's recommendations, explaining whether and why the government will take action (or not) in the way it's decided to

One issue with understanding the current state of competition in the financial sector is the lack of routine public analysis and assessment. While there is no doubt a wealth of analysis on competition in the financial sector, the public is often limited to anecdote and study by private organizations. By committing to routine assessment of the state and direction of competition in the Canadian financial sector, the Department of Finance can create a valuable source of information for the public. This would be in line with the good work of other public institutions such as the Canadian Radiotelevision and Telecommunications Commission (CRTC) and Innovation Science and Economic Development Canada (ISED) to understand the evolution of competition in the telecommunications sector.

With the Competition Bureau's new powers to conduct in-depth studies of the state of competition in markets as a result of Competition Act amendments in Bill C-56, the Department has a strong ally in support of a more competitive financial sector. Echoing the routine review of the Bank Act, on a routine basis the Department of Finance and Competition Bureau should collaborate on an analysis of the state of competition in Canada's financial sector. To inform a broader understanding of financial sector competition, the findings should be made public and the Minister of Finance should have to table a response to the findings and any recommendations put forward by the Department of Finance and Competition Bureau.

Recommendations

- ✓ Create competition mandates for federal financial sector regulators, such as OSFI in its role as prudential overseer, FCAC as consumer watchdog, and the Bank of Canada in its role as payment system overseer
- ✓ Explore the creation of a college of regulators to promote more harmonization and coordination between different regulatory agencies
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We believe Canada needs a long-range, comprehensive policy agenda—constituting a whole-of-government approach—to promoting competition in the financial sector without compromising its stability.

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