Review of the Federal Financial Sector Framework

Submission to the Department of Finance Canada

Prepared by Canadian Bankers Association

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ASSOCIATION DES BANQUIERS CANADIENS
CANADIAN BANKERS ASSOCIATION

EXPERTISE CANADA BANKS ON
LA RÉFÉRENCE BANCAIRE AU CANADA

Introduction

The Canadian Bankers Association welcomes the opportunity to respond to the second consultation paper issued by the Department of Finance as part of its Review of the Federal Financial Sector Framework. The CBA is the voice of more than 60 domestic and foreign banks that help drive Canada's economic growth and prosperity. The CBA advocates for public policies that contribute to a sound, thriving banking system to ensure Canadians can succeed in satisfying their financial goals while obtaining banking products and services through existing and evolving channels.

Canadian banks are a key driver of economic growth, representing approximately two-thirds of the business lending market and roughly one-quarter of the overall business financing market in Canada. In 2016, total authorized credit to businesses surpassed $1 trillion, of which $214 billion was authorized to and in support of small and medium-sized businesses. The contribution of the banking industry to Canada's GDP has grown by more than 20 percent over the past seven years, accounting for approximately 3.4 percent, or close to $60 billion, of GDP as of December 2016. Canadian banks have contributed to job creation by employing more than 275,000 Canadians in a workforce that reflects the diverse fabric of Canadian society and labour market. Banks and their subsidiaries paid $27.5 billion in salaries and benefits in 2016.

Canadian banks have always been very active in the development of technologically enabled financial innovation that provides solutions to meet the changing financial needs of Canadian consumers. Canadians are embracing these new technologies as more are using online and mobile channels as their preferred means of banking. Constantly looking to the future, banks continue to innovate, working with innovation hubs, launchpads, and non-bank fintech companies to pursue, design, and deliver digital innovations and solutions for their bank customers.

During the first phase of the consultation process, the CBA provided recommendations in light of the dynamic, transformative changes in how banks and non-bank fintech entities deliver financial services to consumers. Banks are strong proponents of a competitive and innovative financial services sector. Banks recognize that the recent emergence of companies that focus on financial technology has had positive impacts on the marketplace by heightening competition and accelerating innovation to benefit consumers. Technology also continues to change the way banks interact with their clients, and it is critical that the legislative and regulatory framework that governs the banking sector evolve to support it. To maintain its relevance and support innovation, the legislative and regulatory framework must be technologically neutral as tomorrow's technology may be strikingly different from today's technology. Canadian banks are continually seeking to develop financial technology in-house and collaborate with non-bank fintech companies in order to innovate and create new applications, processes, products and services to provide the best and most efficient experiences for their customers. For this reason, we strongly support Finance's statement in the second consultation paper that clarifying the fintech business powers of financial institutions and removing obstacles to collaboration between financial institutions and non-bank fintech entities will accelerate innovation, to the benefit of Canadian consumers.

The federal government has made it a priority to create and foster an environment that spurs innovation and economic prosperity in Canada. Permitting greater collaboration between banks and entrepreneurs is vital to accelerate this innovation. Entrepreneurs benefit from having access to capital and a pre-existing client base to scale their operations, while having exposure to the specific expertise that banks have in areas such as risk evaluation and operating in a regulatory environment. Banks benefit by discovering new and innovative products and solutions that their customers demand and expect. Our recommendations will further the policy objectives of innovation, modernization, and competition in banking and financial services in Canada that

Finance has identified as central to this Review. Our recommendations also support Finance's objectives of improving the protection of bank customers, and safeguarding a stable and resilient financial services sector.

We have focused our commentary below on the following key areas highlighted in the second consultation paper:

- **Fintech business powers and collaboration**
- **Exploring the merits of open banking**
- **Cyber risk**
- **Competitiveness of small and mid-sized banks**
- **Improving the protection of bank consumers**
- **Corporate governance**

We have also attached an appendix that will address some of our more technical recommendations, as well as other policy measures raised in the second consultation paper.

The CBA is separately participating in consultations respecting the proposed Retail Payments Oversight Framework. We would encourage Finance to ensure that there is close coordination between the teams responsible for these two consultations, given that many of the issues are connected. Among other things, the degree to which fintech companies, including payments service providers, are regulated from a prudential and conduct risk perspective would be relevant to any policy decision respecting open banking.

1. Fintech Business Powers and Collaboration

As noted above, technological developments are creating significant opportunities for consumers to benefit from new channels of distribution as well as new applications, processes, products and services in the banking sector. Consistent with the federal government's Innovation Agenda, we believe that banks must continue to play a role in offering consumers innovative products and services. In order to do so, it is critical for Canadian financial institutions to be able to engage in fintech activities internally, as well as invest in (through both non-controlling and controlling investments) and work with emerging and established fintech companies, to facilitate the development and delivery of new financial products and services to consumers and support the fintech sector.

Before outlining the specifics of our proposed changes, we would emphasize the need to ensure clarity around the use of terminology and concepts in the rapidly evolving area of fintech. While we appreciate that the reference to "fintechs" in the government's consultation paper is intended to address non-bank fintech entities, i.e.: "*Fintechs (i.e., companies that commercialize emerging financial technologies) are at the leading edge of innovation in Canada, often in collaboration with financial institutions"*, in our view an additional definition of fintech as an activity may be helpful to reflect upon in the context of the range of issues being considered. For example, the Financial Stability Board uses the following definition for fintech: "*Technology-enabled innovation in financial services that could result in new business models, applications, processes or products with an associated material effect on the provision of financial services."*

Reflecting this additional definition, it is apparent that fintech is increasingly intrinsic to and intertwined with the provision of financial services and the business of banking more broadly. Given these developments, we believe that it is critically important for government policy to revisit the historical technology constraints in the current legislative and regulatory framework for banks. The framework needs greater clarity regarding the nature of fintech activities in which banks may engage. Additionally, the removal of barriers that limit fintech access to bank capital and fintech collaboration with banks, is desired by both banks and non-bank fintech entities. We are facing a defining moment for the future of financial institutions and the framework should ensure that banks are positioned to participate in fintech fully in this era of rapid technological evolution.

Currently, the *Bank Act* (BA) precludes certain types of relationships among banks and emerging fintech companies, and imposes barriers on banks making capital investments in emerging fintech companies through lengthy regulatory approval processes, onerous outsourcing requirements or restrictions on the type of investments that banks can make. Many of these legislative obstacles were imposed at a time when there was less clarity on the critically important link between technology and banking activities. While these restrictions may have been appropriate at the time, they are now outmoded in a world where technology is integral to virtually every industry.

As technology has become more closely entwined with the delivery of banking products and services, the legislative and regulatory constraints are inhibiting innovation. For example, many fintech companies may be more willing to work with private equity or large technology companies that are not subject to the same constraints as Canadian banks. In addition, governments in other jurisdictions and international regulators have paved the way for banks to embrace fintech and other technology, which could further erode the ability of Canadian banks to compete domestically and abroad.

For these reasons, we would fully support legislative changes that clarify, modernize and enhance the business powers of financial institutions as they relate to fintech, and facilitate fintech collaboration. We have identified below key elements of the BA that should be amended in order to achieve these objectives.

Clarifying the Fintech Business Powers of Financial Institutions

Section 409(1) of the BA gives banks the authority to carry on the business of banking and such business generally as appertains thereto. In addition, section 409(2) provides that, for greater certainty, the business of banking includes: providing any financial service; acting as a financial agent; providing investment counselling and portfolio management services; and issuing payment, credit or charge cards and, in cooperation with others including other financial institutions, operating a payment, credit or charge card plan. While we believe that technology that facilitates the provision of financial services falls within the scope of the business of banking, we would recommend clarifying any potential ambiguity by expanding section 409(2) to specifically reference the use of technology to facilitate the provision of financial and other services.

Section 410(1)(c) of the BA permits banks to carry on certain additional activities including engaging in the collection, manipulation and transmission of information that is primarily financial or economic in nature with the prior written approval of the Minister of Finance when the activity occurs in Canada. Section 410(1)(c.1) permits banks with the prior written approval of the Minister of Finance to develop, design, hold, manage, manufacture, sell or otherwise deal with data transmission systems, information sites, communication devices or information platforms or portals that are used to provide information that is primarily financial or economic in nature. Nowadays, virtually every industry is engaged in the collection, manipulation and transmission of information using technology and ministerial approval should not be required for banks to engage in such routine activities - as noted above, what banks do today is inextricably linked to technology and we do not believe that this outdated framework can logically exist in today's environment. Nor do we believe that the complex approval processes requiring Ministerial involvement is proportionate or necessary when considering the risk profile of technological activities. Further, Ministerial approval can take three to four months and is limited to the specific activities contained in the application rather than a general approval to carry on any such activities, which represents a major barrier to working with non-bank fintech companies whose activities are constantly evolving.

As a result, we would recommend moving the types of activities set out in sections 410(1)(c) and 410(1)(c.1) that relate to financial or economic information into section 409(2). In addition, we would recommend removing the requirement to obtain ministerial approval from the remaining portions of sections 410(1)(c) and 410(1)(c.1) (i.e. information processing and information platforms/portals relating to information that is not specifically primarily financial or economic in nature).

Facilitating Fintech Collaboration – Referral Arrangements

Section 411 of the BA permits banks to enter into referral arrangements with other financial institutions and "permitted entities". We believe that banks must have greater latitude to network with, or refer clients to and promote the services of, any entity (whether or not such entity is "permitted"), particularly as lines blur between financial and non-financial services and products from a user-experience perspective.

We view the current powers under section 411 as unduly restrictive from both the perspective of the banks and the perspective of non-bank fintech companies because a broadened power could propel competition in the non-bank fintech and other sectors by expanding the networks, distribution channels and customers available to these companies. In addition, we do not see a policy or prudential concern with allowing banks to network with any entity - in fact, it is critical that banks are able to satisfy customer expectations and serve their customers by ensuring they are connected to non-bank fintech and other companies for services and products that may enable customers to make better and more efficient financial decisions. As such, we recommend that section 411 be amended to allow banks to network with, make referrals to, and promote the services of, any entity.

Facilitating Fintech Collaboration – Permitted Investments

Section 468(2)(a) of the BA permits a bank to invest in an entity which is engaged in a financial service activity in which a bank is permitted to engage under any of sections 409(2)(a) to (d). This provision precludes a bank from making a substantial investment in a company which is only carrying on business which generally appertains to the business of banking (section 409(1)), thereby limiting a bank's ability to invest in non-bank fintech companies whose business models may not fit squarely within the parameters set out in the BA and related guidance.

In addition, under section 468(2), if a bank's investment is not made in a regulated financial institution, the business of the entity being acquired must be limited to certain enumerated permitted activities. If, in addition to its primary business, a company carries on any activities that are not permitted activities for banks, to any extent, then a bank is not permitted to invest in the company, even where its primary business is a permitted investment for a bank under the BA. Therefore, when making a substantial investment in a company, the activities of that company and of every company in which that company holds a substantial investment have to be analyzed to ensure that those activities, as well as the activities of any downstream investments, are permitted under the BA. If any of the activities of the entity or any of its downstream investments change, a bank may need to divest its investment or seek regulatory approval to re-categorize it as a permitted investment. In the world of fintech where companies look to be innovative and leverage existing capabilities to take advantage of new opportunities, often on an accelerated basis, the inability of banks to invest in a non-bank fintech company, or maintain an investment in a non-bank fintech company where even one of the non-bank fintech company's ancillary activities or downstream investments is not permitted under the BA, could be of concern for the non-bank fintech company and discourage the fintech company from working with banks. This constitutes a significant impediment that has the potential to unduly restrict Canadian innovation. Industries are increasingly interconnected and are no longer occupying single fields. It is not feasible nor is it logical for the BA investment provisions to limit a bank's investments to entities based on defined classifications that may no longer apply.

Facilitating Fintech Collaboration – Investments in Information Technology Activities

The *Information Technology Activities (Banks) Regulations* under the BA permit the making of substantial investments in entities which develop, design, hold, manage, manufacture, sell or otherwise deal with data transmission systems, information sites, communication devices or information platforms or portals that are used to provide information services of up to 5 percent of the bank's regulatory capital without any approval (an Exempt Technology Investment). The regulations require the entity's activities to be "limited to" the specified enumerated activities in order to qualify as an Exempt Technology Investment that does not require approval of the Minister of Finance. Although this regulation was promulgated in 2003, it has not been used to a significant extent by the banks because there are very few companies whose activities are limited to the prescribed activities. However, we agree with the concept and would recommend revising the Exempt Technology Investment power to include any entity primarily engaging in technology activities. This revision would modernize the regulation and help provide additional flexibility to banks seeking to rely on these regulations.

Improving Regulatory Transparency and Coordination

We are pleased to see Finance's commitment to support greater financial innovation by working with provincial and territorial regulatory authorities to better coordinate and share information. We believe it is important that the federal government work together with the provinces and territories in facilitating innovation to ensure a consistent national approach. Finance may also wish to consider collaboration with jurisdictions outside of Canada.

Further, we believe that the creation of dedicated 'fintech facilitation offices' at the relevant government department would expedite regulatory transparency and coordination. In the federal sphere, a 'fintech facilitation office' could be embedded within a policymaker, such as the Department of Finance, with representation from key regulatory agencies, such as the Office of the Superintendent of Financial Institutions (OSFI), the Financial Consumer Agency of Canada (FCAC), the Financial Transactions and Report Analysis Centre of Canada (FINTRAC), and the Office of the Privacy Commissioner. Such an office should also establish co-operation and collaboration protocols to review initiatives that involve more than one Canadian or foreign jurisdiction, in order to further support coordination among the federal, provincial and territorial, and where applicable global, authorities to the benefit of both banks and non-bank fintech companies.

2. Open Banking

As noted above, Canadian banks are strong proponents of a competitive and innovative financial services sector that utilizes rapidly advancing technology to better serve customers and meet evolving client expectations, and we want to work with the government to accomplish that goal. Therefore, we are supportive of Finance exploring the merits of open banking with a view to determining potential benefits and risks for Canadians. The consultation paper indicates Finance's intention to consider how open banking has been implemented in other jurisdictions. In this context, we note that third party access initiatives have taken on various forms in foreign jurisdictions – e.g. Australia, the European Union, Japan, the United Kingdom and the United States – and that many of these initiatives appear to be addressing concerns that may not be present in Canada. Additionally, there is a need to gauge consumer demand for third party access which may also vary across jurisdictions. We would underscore that it is imperative that the implications and potential risks of open banking for the Canadian context be comprehensively assessed, taking into consideration the unique Canadian environment and economy, before any legislative or regulatory measures are introduced. As the consultation paper notes, protecting consumers' security and privacy will be key to any framework aimed at increasing third party access to financial data and systems. In addition, consideration must be given to the potential impacts on the safety, soundness and stability of the overall financial system in Canada, given the potential for third party access to give rise to contagion, reputational and other types of risks with broad-ranging consequences, and for the ability of banks and other market participants to manage their legal obligations.

Banks in Canada have always been regarded as trusted custodians of their customers' highly sensitive personal and confidential information. Accordingly, Canadian banks have devoted very significant resources to creating well-established information security and data warehouses that meet the highest standards worldwide. Any initiative that could undermine this trust would be very problematic for Canadian consumers, financial market participants and the broader economy. From the perspective of safeguarding customers, the following key risks and challenges should be considered in the context of third-party access to customer data:

- Identity and request verification
  - verifying customer instructions when requests are made by a third party;
  - verifying legitimacy and capacity of third party, including ability of third party to comply with anti-money laundering and anti-terrorist financing laws;
- Informed consent
  - ensuring customers fully comprehend the scope and use parameters around data sharing, including the risks associated with different types of data, and their rights with respect to revoking access by third parties.

From a broader safety and soundness perspective, the following sources of risk, which could also have highly negative impacts on consumers, should be considered:

- Security of customer data and protection against fraud
    - ensuring sufficient levels of security safeguards across market players that currently have varying levels of controls;
    - ensuring that third parties given access to data are accountable and face reviews and audits once data is received;
    - assessing the impact on fraud and cybercrime risk, including possible account takeover by third parties and identify theft, with respect to the systems of both banks and other market players (banks may have reduced ability to manage fraud if they lose direct access to customer transaction and device data, for example);
    - secure transfer and storage of data by all market players;
    - prevention of data misuse, once data has been shared with third parties;
- Regime governance
    - ensuring consistent standards and obligations among participants;
    - ensuring participants are compliant with those standards and obligations.
- Propagation of malware and other cyber risks beyond the originating system

Finally, from a legal and regulatory perspective, consideration should be given to:

- Privacy obligations
    - assessing implications of increased complexity of data access and sharing arrangements for adherence to applicable privacy laws;
    - ensuring consumer comprehension of individual privacy rights, including legitimate use of personal data;

- Risk allocation
    - Allocation of liability among market players in situations of data misuse.

Prior to any introduction of open banking in Canada, the risks noted above, and any others arising from the above, must be appropriately and methodically addressed, regardless of the size or activities of the entity performing functions on behalf of consumers. Absence of certainty as to how these risks are to be addressed will impede the development of consumer confidence in open banking, which in turn will limit consumer appetite for innovative products and services that may be developed as a result of open banking. Further, new entrants into the market will need certainty as to their risk exposures and legal obligations prior to committing their resources to developing such products and services. We would welcome the opportunity to work with the federal government on first fully understanding the risks associated with open banking and seeing how those risks can best be mitigated, before considering adopting any open banking frameworks in Canada.

3. Cyber risk

Cyber security is of utmost importance to Canada's banks and financial services in general. The digitization of business and the growth of the "Internet of Things" creates new business opportunities but also new vulnerabilities, including cyber attacks. The World Economic Forum reports that cyber attacks alone cost the global economy $445 billion annually. Banks in Canada are at the forefront of the prevention and detection of cyber security threats. Banks have invested heavily in cyber security and have sophisticated security systems in place to protect customers' personal and financial information. In addition, banks actively monitor their networks and continuously conduct routine maintenance to help ensure that online threats do not harm their servers or disrupt service to customers.

We strongly support the government's goals of creating a new cyber security strategy and making Canada a global leader in the provision of cutting-edge cyber security technology. A collaborative, coordinated public/private approach to cyber security is essential. As leaders in the prevention and detection of, and responses to, security threats, banks work closely with each other and with bank regulators, law enforcement and all levels of government to share industry leading practices and other information to address the growing challenges posed by cyber crime. The financial sector relies on other critical infrastructure sectors, most notably telecommunications and energy (electric power), to deliver services to Canadians. We are reminded of cyber security risks on a regular basis through media reports on cyber attacks that affect millions. As a result, it is imperative to ensure consistent oversight across critical infrastructure sectors to help safeguard the integrity of the financial system. Consistency of global cyber standards is equally critical for banks, and we support Finance's pursuit of greater international cooperation on cyber security in the financial sector.

With its highly-educated workforce and the federal government's commitment to the Innovation Agenda, Canada is well-positioned to become a global leader in groundbreaking cyber security technology. Canadian innovation in this area should be encouraged at all levels of government and the public/private sector. Expanding the ability of banks to invest in, and partner with, domestic and international companies that provide novel solutions to cyber security problems would help to drive growth and innovation, and to protect Canadians and the Canadian economy from cyber crime.

4. Competitiveness of Small to Mid-Sized Banks

We are pleased to see the consultation paper highlight the important contributions of small and mid-sized banks to long-term economic growth in Canada, as well as their role in enhancing innovation and competition in financial services. We agree that these objectives need to be balanced against a well-managed regulatory and legislative framework for oversight and risk. In our view, there are opportunities to recalibrate the balance between these policy objectives. Small and mid-sized banks that are not designated as domestic systemically important banks, referred to here as non D-SIBs can face disproportional impacts from additional regulatory and capital expectations which are not aligned with the risks these institutions could pose to the Canadian financial system.

Regulatory burden

It is important that Finance and OSFI are sensitive to important discrepancies in the resources and level of systemic risk among the various players within the Canadian banking sector. Growing regulatory requirements can have a disproportionately greater impact on the non D-SIBs given the scale of their operations. Although the consultation paper notes that small and mid-sized banks are regulated in a manner proportionate to their size, risk and complexity, there are opportunities to recalibrate the balance to be more aligned with an institution's level of risk. There are numerous areas where a re-examination would be beneficial including with respect to: accommodations on the timeline for satisfying the requirements to obtain an Advanced Internal Rate Based (AIRB) approach accreditation; right sizing the documentation, stress testing and risk management requirements for recovery plans; and minimizing duplication with respect to regulatory reporting requirements.

Capital Expectations

Small and mid-sized banks may face disproportionate capital requirements. Firstly, as noted in the consultation paper, small and mid-sized banks often target different areas and market segments, such as small business. The Basel capital framework sets out capital requirements by loan type and non D-SIBs may not be able to align with the optimal asset mix under the Basel regime. Furthermore, non D-SIBs using the standardized method to calculate regulatory capital are required to carry more capital for the same loan type relative to a bank utilizing the AIRB method. This differential results in most non D-SIBs focussing on retail offerings rather than lending to commercial entities.

The consultation paper notes that the statutory minimum initial capital requirement for banks has been reduced from 10 million dollars to 5 million dollars. However, this provision has had limited impact as OSFI's *Guide for Incorporating Banks and Federally Regulated Trust and Loan Companies* requires additional capital requirements including meeting the requirements of OSFI's *Capital Adequacy Requirements Guideline*. As part of this consultation, the government should consider a revised framework which ensures that OSFI guidance supports Finance's objective of enhancing the contributions of non D-SIBs to the Canadian economy.

5. Improving the Protection of Bank Consumers

The banking industry has long supported a strong federal consumer protection framework. Fragmentation of a national banking system leads to consumer confusion and impairs the ability of the federal government to inform and protect consumers. A consistent set of rules and regulations helps to foster innovation and competition in financial services by permitting banks to more quickly respond to customer demand by developing and enhancing products and services that are available and consistent in all provinces and territories.

As noted in the consultation paper, Canadian consumers already benefit from a strong consumer protection regime for financial services. However, the banking industry fully supported the federal framework proposed in Bill C-29, Budget Implementation Act, 2016 No. 2, as an important step to further improve upon that regime with clear, streamlined, and consistent regulations that would apply across the country. Bill C-29 set out a clear federal framework designed to both keep pace in meeting consumer needs and provide clarity to guide the operations of federally-regulated banks. We support moving forward with the measures proposed in 2016 as we believe that consolidating consumer protection and establishing a uniform set of standards under a single framework will:

- Improve the efficiency of financial services regulation;
- Ensure consistent policy across the country;
- Prevent consumer confusion;
- Maximize product availability;
- Enhance the capacity of the FCAC to fulfill its mandate to inform and protect consumers; and
- Ensure innovative products and services are available to all Canadians on the same basis.

The stability and efficiency of the Canadian banks is founded on a streamlined regulatory system with national laws applicable across the country and with a single regulator responsible for safety and soundness – OSFI – and a single regulator for consumer protection – the FCAC. We agree that Canadians benefit from a dedicated consumer protection regulator, the FCAC, and we support the consumer protection framework being placed under the oversight of a single regulator.

With respect to the sales practices reviews, we note that the FCAC and OSFI regularly conduct reviews of the banks' business practices and the banks fully cooperate with them on these reviews, and we support continued federal oversight over these matters. Banks are in the customer service business and work hard to provide the services and products that are right for their customers, including providing the information they need to make informed decisions when choosing financial products and services. To support this goal, banks have codes of conduct in place with clear expectations regarding employee behaviour, performance management systems that are designed to reinforce a client-centric and advice-driven approach, and internal and external complaint processes.

6. Corporate Governance

Strong governance practices at institutions support innovation and competition by creating a climate where ingenuity and creativity can flourish, and where the results of those efforts are visible to shareholders and other institutional stakeholders. We are pleased to see that Finance's consultation paper highlights that federally regulated financial institutions are recognized leaders in establishing and applying strong corporate governance frameworks, and support in principle Finance's proposed measures to enhance corporate governance. We also agree with Finance that, while the same governance principles generally apply to all federally regulated financial institutions irrespective of size, the implementation of those principles may give rise to challenges for smaller institutions. We note Finance's recognition that publicly listed institutions already follow some of the proposed corporate governance practices where Finance is seeking stakeholder views. We strongly encourage Finance to harmonize the corporate governance aspects of the federal financial institutions statutes with existing rules applicable to publicly listed institutions, such as those of the Canadian Securities Administrators (CSA) and the Toronto Stock Exchange (TSX).

Promoting Diversity on Boards

The CBA strongly supports the existing "comply or explain" model established by the CSA to promote the participation of women on boards of directors and in senior management. Banks proactively support and foster diversity and inclusion in their workforces. Many CBA members have formal and informal diversity policies, programs and practices in place aimed at promoting diversity. As of 2017, Canada's six largest banks have, on average, 36 percent women on their boards of directors and have publicly disclosed policies relating to board diversity, including gender diversity. Banks are leaders in terms of representation of women at several levels, including executive and middle management levels.

In 2014, the CSA adopted new rules regarding annual disclosures in connection with the representation of women on the board and in executive officer positions. Publicly listed financial institutions comply with these rules. In 2015, Ernst & Young LLP released a report on disclosures in Canada and other jurisdictions regarding corporate governance practices. The report stated that "[w]e have found that entities with comprehensive gender diversity policies and disclosures are, for the most part, from the financial services sector. Many financial institutions concluded years ago that inclusiveness was a critical success factor for their business and have acted accordingly." Most banks have adopted board diversity policies that include gender diversity targets and practices regarding gender diversity in senior management. In addition, a number of banks signed the Catalyst Accord, which sought to increase the representation of women directors of Financial Post 500 boards to 25% by 2017. Further, some of our member banks are members of the 30% Club Canada, an organization that seeks to achieve 30% women on boards. We fully endorse efforts to achieve gender balance in the governance of federally regulated financial institutions.

Strengthening Shareholder Democracy in the Election of Directors

The CBA supports the government's objective of ensuring that shareholders have a strong voice in fundamental corporate matters. As a matter of practice, many banks already hold annual elections and individual director elections, and have adopted majority voting policies for directors in uncontested elections. With respect to majority voting specifically, the current TSX approach is appropriate, as it provides a meaningful way for securityholders to hold individual directors accountable while granting financial institutions the flexibility and discretion to ensure that there is minimal disruption to the operations of a board and continued stability in the event of one or more nominees receiving less than majority support.

Distributing Meeting Materials and Annual Statements

Consistent with the proposed changes to the *Canada Business Corporations Act* (CBCA) in Bill C-25, the use of the notice-and-access approach should be permitted for all federally regulated financial institutions. The BA should be amended to expressly provide for notice-and-access that would permit communications to be sent to shareholders by making them available on the bank's website and through the System for Electronic Document Analysis and Retrieval and sending notice of their availability to the shareholder. Shareholders would have the option of requesting paper copies of the materials from the bank. The proposed amendment would substantially reduce the volume of paper and other resources consumed in the production of unwanted paper copies of continuous disclosure materials. Banks in Canada are proud of their record as leaders in environmentally-friendly approaches to serving customers and supporting the economy. While banks have been effective in "greening" their operations, they are constrained in some areas by these out-of-date regulations. In this regard, it will be important that the BA amendment permit the use of notice-and-access for both the management proxy circular and the annual financial statements, as the latter forms the bulk of the mailing package.

Strengthening Corporate Transparency

Finance is seeking views on whether to prohibit bearer shares and bearer share warrants in order to strengthen corporate transparency. Consistent with Bill C-25, we support the prohibition of these instruments. Bearer shares and bearer share warrants do not include the name of the holder on the physical stock certificate and the certificates can be transferred without further documentation. These instruments allow holders to remain anonymous, making it difficult to determine the precise ownership of entities that issue such instruments. Consequently, bearer shares and bearer share warrants are vulnerable to misuse for money laundering and terrorist financing. We encourage the prohibition of these instruments to enhance corporate transparency.

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Conclusion

The CBA strongly supports the government's commitment to furthering the objectives of innovation, modernization and competition as part of this Review, as well as improving consumer protection and safeguarding the stability of the financial sector, and our recommendations support these objectives. The 2019 Review offers the opportunity to introduce reforms that we believe are necessary to bring the BA and other legislation impacting the financial services sector fully in line with the market realities and customer expectations of the twenty-first century. We appreciate this opportunity to provide our comments on the second consultation document for the Review of the Federal Financial Sector Framework, and look forward to continuing to provide our views on these important issues as the Review progresses.

Appendix – Technical amendments to the *Bank Act* and other federal financial services statutes

Set out below are the CBA's recommendations for technical amendments relating to modernization, as well as other recommendations and clarifications relating to certain issues raised in Finance's second consultation paper.

Modernization of federal financial sector framework

The consultation paper notes that one of the themes for this Review is modernization of the framework. Set out below are some areas of the framework that would benefit from modernization in order to allow the banks increased flexibility in managing their business and operations.

Client Authentication

While client identification requirements under anti-money laundering/anti-terrorist financing legislation have been modified to provide for more flexible methods for the non-face-to-face identity verification of individuals, these requirements continue to be highly prescriptive. They are also focused primarily on Canadian sources and specifically preclude the use of equivalent sources (e.g. a non-Canadian credit file) that could facilitate the identification of certain segments of the Canadian population. These requirements, which are interpreted by FINTRAC, should be further "future proofed" taking into consideration emerging trends and innovations in identity verification methods such as document review through methods such as a live video connection, digital identity products, biometrics and other methods that will likely become available in the near future. For example, Apple just announced the launch of iPhone X and the introduction of facial scanning to unlock the device. Facial recognition is not new, but Apple's introduction of this security feature in a phone signals it will soon become ubiquitous. For the regulatory framework to continue to support and keep pace with rapidly evolving technological innovation, it must be flexible, technologically neutral and principles based, with oversight tied to scale and the risks presented. Many of these methods have the potential to be comparable to or to prove a customer's identity even more securely, accurately, and conveniently for consumers, than the use of physical identification.

Location of Bank Records

Section 239 of the BA requires the bank to keep at its head office (or at such other place in Canada as the directors see fit) certain bank records as detailed in section 238, including "records showing, for each customer of the bank, on a daily basis, particulars of the transactions between the bank and that customer and the balance owing to or by the bank in respect of that customer …" Customer records are primarily maintained electronically and servers that store this information are often located, for security and other reasons, in data centres away from a bank's head office rendering this provision unclear. We recommend that section 239 be amended to clarify that records which are electronically accessible from the head office meet the requirement to maintain the records at the bank's head office.

For authorized foreign banks, there is a similar lack of clarity in section 597. It is unclear whether records that are centrally managed in a foreign jurisdiction (i.e. the authorized foreign bank's parent head office) but are electronically accessible by the authorized foreign bank meet the same requirement to keep them at the authorized foreign bank's principal office. This lack of clarity may also be extended to scenarios where records may be moved to the cloud.

Limitations on Using the Terms "Bank", "Banker" and "Banking"

We agree with the commentary in the second consultation paper that it is important for consumers to know when they are dealing with a bank, rather than another type of financial service provider, as banks are subject to protections and obligations created by the federal banking framework. Therefore, we believe it is necessary for Finance and OSFI to continue to have strict parameters around the use of the terms "bank" and "banker" so that, as noted in the consultation paper, there is appropriate disclosure to consumers and marketplace confusion is mitigated. It may be appropriate to permit non-banks some flexibility in the use of the term 'banking' when they are describing their services, provided that there continue to be parameters around that use, and provided that it is made clear to customers that they are not being served by a bank. We also support financial literacy programs by both federal and provincial governments and regulators regarding the different protections and obligations of non-bank deposit-taking institutions relative to banks.

Unclaimed Balances

We believe that the administration of unclaimed balances should be modernized. Currently, section 438 of the BA deals with Canadian dollar deposits, cheques, drafts and other bills of exchange. Unclaimed balances arise from many other bank products, including foreign currency deposit accounts, credit card and prepaid card accounts, travellers' cheques and safety deposit boxes. The BA should be amended to make it clear that the unclaimed balances provisions also apply to these other bank products, so that unclaimed balances on all bank products may be remitted to a single federal entity. We would welcome the opportunity to discuss the modernization of administration of unclaimed balances in more detail.

Increases in Significant Interest

We support the proposal to exempt persons who already control a FRFI from having to seek Ministerial approval for indirect increases in their share ownership, as the imposition of an approval requirement when the FRFI is indirectly increasing significant interest does not change the control framework in place.

Electronic Meetings

We understand that Finance is considering amending the federal financial institutions statutes to increase electronic participation in shareholder meetings, so long as access to a physical meeting in Canada is provided. We support efforts to increase shareholder participation in meetings through electronic means. Finance may also wish to evaluate the merits of allowing virtual-only meetings, which the CBCA expressly permits. In our view, the financial institution should have the discretion to determine from time to time whether to hold an electronic meeting (whether virtual-only, if permitted, or hybrid), considering such factors as the topics to be discussed at the meeting and the availability of technology to facilitate the meeting.

Related-Party Regime

We believe that the proposals in the second consultation paper relating to the related-party regime warrant further consideration and we would welcome the opportunity to have discussions with Finance regarding this issue.

Substantial Investments Regime

Finance is seeking views on a number of items related to the substantial investment regime under federal financial sector legislation. We have set out below our recommendations on these items.

- *Establishing a materiality threshold for Superintendent approval of the acquisition of unregulated entities, up to 2 percent of the consolidated assets of the acquirer;*

  We are supportive of this proposal since a materiality threshold would address any potential prudential concerns while providing banks and other federally regulated financial institutions (FRFIs) with greater flexibility in how they manage their businesses.

- *Eliminating Superintendent approval where a FRFI acquires control of a limited partnership investment fund (that is not a mutual fund entity or closed-end fund) only because it controls the general partner of that partnership. This potential change would recognize that limited partners, and not general partners, are exposed to a fund's market or credit risk;*
  We are supportive of this proposal for the reason stated by Finance.

- *Requiring Superintendent approval for the acquisition of control of a factoring or financial leasing entity, subject to the materiality threshold. This potential change would make the federal framework more consistent, as these entities can pose credit risks similar to those posed by finance entities, where Superintendent approval is currently required;*
  Provided that Finance proceeds with introducing the 2 percent materiality threshold for Superintendent approval noted above, we would not object to this proposal.

- *Mutual fund distribution and real property brokerage entities - "principal and primary activities"*
  As discussed above in connection with permitted investments in fintech companies, we strongly support the introduction of flexibility for banks to invest in companies whose business models may not squarely fit the parameters set out in the BA and related guidance. For the same reasons as noted in that discussion, namely that limiting bank investments to those entities that exclusively engage in authorized activities unduly hampers banks' ability to be competitive, we believe that the principal and primary activities tests for, respectively, mutual fund distribution entities and real property brokerage entities should be retained.

- *Reclassification of investments*

  In some circumstances, investments made by a bank can be illiquid and difficult to divest immediately following the time period during which the investment was permitted, for example where there is no market for the investment or there would be reputational or other risks associated with divestment. Banks have experienced this in multiple scenarios and find the ability to reclassify the investment a useful tool that offers greater flexibility in managing these situations, with proper supervisory oversight. The OSFI Advisory on Substantial Investments, issued in 2015, requires that the bank notify OSFI of the reclassification and inform OSFI of the bank's future plans for the investment. Therefore, we believe that the current practice of having the retention period associated with the reclassification of the investment take effect from the date of reclassification, without regard to any prior holding period associated with a previous classification, is reasonable and should be retained.

- *Indeterminate extensions*

For the same reasons as noted above in our comments on the reclassification of investments proposal, we believe that indeterminate extensions should be retained – namely, that they are an additional tool that provides greater flexibility in managing investments. Further, we note that, in this context, the Minister or Superintendent, as the case may be, have approval powers in respect of the extension, therefore ensuring that there is oversight from the policy-maker or supervisor, respectively.

Frequently Traded and Easily Valued Assets

Finance is seeking views on whether to narrow the scope of large asset transactions excluded from the requirement to obtain Superintendent approval. Generally speaking, we are against narrowing the exemption from Superintendent approval. We are concerned that this would hamper the banks' ability to execute transactions that are required to meet their obligations and objectives (e.g. for liquidity). In addition, broadening the requirement for Superintendent approval from “large asset transactions” to include “transactions involving significant financial risk” would be quite a material change, and it is furthermore unclear how these transactions would be defined. In order to opine fully, we would need to be provided with more detail on the proposal.

As such, we would be interested in discussing with the government any potential change in the scope of the exemption for frequently traded and easily valued assets. The industry is not clear how the exemption would be modified and would want to ensure there are no unintended consequences. For example, the industry would expect that normal trading activity (security sales, repo, and stock borrow/lend activity) with the same counterparty over a 12-month period would not trigger review by the Superintendent.

In addition, we would ask that any increases in regulatory burden related to accessing capital market transactions be carefully considered, especially as they relate to small institutions. In this instance, we have concerns that a narrowing of the scope for transaction exemptions could disproportionately affect small institutions. Even using a ‘10 percent of assets’ definition translates to a lower absolute threshold for smaller institutions. Despite this lower threshold, smaller institutions may be expected to deliver transaction volumes commensurate with evolving market expectations, and those expectations will not necessarily vary by institution size. As a result, smaller institutions will face regulatory hurdles which large institutions will not, for similar transactions. We are concerned that this would complicate the timing of market access and lead to inefficiencies in transaction execution for smaller institutions.

CDIC Claims in Liquidation

Finance is seeking views on whether to change the *Canada Deposit Insurance Corporation Act* to clarify that a liquidator of a CDIC member institution has no right to apply set-off against a claim related to insured deposits. We do not object to CDIC claims being exempt from set-off in liquidation.