# TRENDS

## BANKING

As part of our series on current trends across different industries, we look at what's on the horizon for banking in 2017.

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### Moves Towards Regulatory Modernization

The rapidly evolving nature of banking — and the financial services sector in general — has seen Canada's Department of Finance make several moves towards modernization. What will this look like? With the outcomes of several consultations due over the next few months, we can expect to see a clearer picture develop during 2017.

The broad sweep of last August's consultation document *Supporting a Strong and Growing Economy: Positioning Canada's Financial Sector for the Future* encompassed everything from the safety of the sector to how it meets the financial needs of consumers and effectively contributes to economic growth. While it was low on detail, the consultation document put forward a starting point for change. It is expected that fintech investment and collaboration will be included as part of this change; the current technology provisions of the *Bank Act* have been the same since 2001, years before the iPhone even existed, and are massively outdated. Participants in the consultation process will be watching with interest when the policy paper is published this year, with changes expected to be finalized in 2019.

In December 2016, the more immediate proposal for a comprehensive consumer financial code in the *Bank Act* was removed from Bill C-29 for further consideration. This happened as a result of criticism from the Quebec government regarding the federal government's desire to regulate federal banks in the consumer protection area. Although the federal government has promised to reintroduce a version of this reform — designed to recreate exclusive federal jurisdiction banking regulation — it remains to be seen whether the proposal will be reintroduced with amendments to its consumer protection or constitutional provisions.

We can also expect to see changes to the *Compliance Framework* of the Financial Consumer Agency of Canada (FCAC), the market conduct regulator for banks. The FCAC recently published two documents for comment: *Proposed Supervision Framework* and *Publishing Principles for FCAC Decisions*.

Changes on the horizon could include a more transparent risk-based approach to supervision, including a two-tier system for classifying regulated entities, introduction of a rulings process and a new notice of breach enforcement tool.

The Department of Finance is moving towards other changes in this sector by reviewing the country's deposit insurance framework, continuing its assessment of the housing finance framework and considering federal oversight of national retail payments systems, among other initiatives. There is also the Competition Tribunal's report on fintech, which is due in the next few months, following its own investigation.

The strong possibility of moves towards modernization mean that 2017 is a year in which financial institutions should keep a close watch on developments and be aware of any associated regulatory risks.

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## Regulatory Scrutiny of Real Estate Markets

High levels of household debt, low interest rates and rapid house price increases have triggered an increased focus on risk related to residential mortgages. Over the last year, the Department of Finance, the Bank of Canada, Canada Mortgage and Housing Corporation, and the Office of the Superintendent of Financial Institutions (OSFI) have all taken actions to cool the housing market and reduce risk to borrowers, lenders and insurers.

OSFI started 2017 by adopting another more risk-averse approach in this area. On January 1, the final version of OSFI's *Advisory Capital Requirements for Federally Regulated Mortgage Insurers* became effective. This advisory updates the capital requirements for mortgage insurance risk and is intended to ensure that mortgage insurers can absorb severe but plausible losses. Also in force is OSFI's updated *Capital Adequacy Requirements 2017*, which implements revisions to the capital treatment of insured residential mortgages held by banks and federal trust and loan companies.

These measures follow last summer's letter from OSFI to all federally regulated financial institutions outlining several areas related to underwriting practices for residential mortgages that would be subject to enhanced supervisory scrutiny.

OSFI's approach of conservatism and caution is unlikely to change in the context of property markets and, if anything, 2017 could see its scrutiny on mortgage underwriting increase.

A key development to watch for in 2017 is whether the federal government will move forward with a possible risk-sharing framework between lenders and mortgage insurers that could require lenders to retain and manage a portion of loan losses on defaulted insured mortgages. Such a move would be strongly opposed by lenders.

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## Fintech Partnerships on the Rise

While countries such as Australia, Singapore and the United Kingdom have made bold strides with fintech regulation, Canada has cautiously tiptoed towards change.

Changes to the provisions that hinder the involvement of banks in innovative financial services will be at the top of the banks' wish list for proposed changes to the *Bank Act* (as part of the consultation mentioned above), but 2019 is a long time to wait for the necessary changes.

In the meantime, one solution for banks will be to build upon the 2016 trend of partnering with smaller fintech organizations. Smaller fintech companies can offer larger banks access to innovative approaches and the latest technology, while the banks, in turn, offer valuable experience in matters such as regulatory compliance, risk management and international profile. The mutual benefits continue to make partnerships an attractive option.

For further information, please contact Dawn Jetten, Paul Belanger or any other member of our Financial Services Regulatory group.

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