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BY EMAIL

Financial Institutions Division
Financial Sector Policy Branch
Department of Finance Canada
James Michael Flaherty Building
90 Elgin Street
Ottawa, ON K1A 0G5

Attention: Director

Re: Second Consultation Paper: Policy Measures to Support a Strong and Growing Economy: Positioning Canada's Financial Sector for the Future

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The undersigned is submitting these comments in response to the Department of Finance's Second Consultation Paper: Policy Measures to Support a Strong and Growing Economy: Positioning Canada's Financial Sector for the Future (the "**Consultation Paper**"). These comments may be disclosed in whole or in part.

Overview

These comments discuss certain topics identified in the Consultation Paper, specifically, the matters identified under "Clarifying the Fintech Business Powers of Financial Institutions" and "Facilitating Fintech Collaboration". These topics are discussed in the context of permitted statutory authorities for banks under the *Bank Act* (Canada) (the "**Act**").

Examining Fintech

Under the topic "Clarifying the Fintech Business Powers of Financial Institutions" in the Consultation Paper, it is stated that: "Federally regulated financial institutions are generally prohibited from commercial activities and investments. This long-standing policy keeps institutions focused on their core area of expertise: financial services."[1] Under the topic "Facilitating Fintech Collaboration" it is stated that: "Facilitating collaboration must be balanced with the policy objective of limiting federally regulated financial institutions from engaging in commercial activities."[2] In examining these items posed in the Consultation Paper, it is necessary to examine the Act, certain historical antecedents to the Act, and judicial and regulatory

[1] Consultation Paper, p. 7.
[2] Consultation Paper, p.8.

interpretation of the Act. In this submission, we apply the definition of fintech used in the Consultation Paper: fintech is defined as "emerging financial technology".

The Powers of a Bank under the Bank Act

A bank is a unique type of corporation, governed under the Act. Predictably, many of the provisions of the Act replicate the provisions of the *Canada Business Corporations Act* (the "**CBCA**").

A bank governed under the Act has the capacity of a natural person and, subject to the Act, the rights, powers and privileges of a natural person.[3] A corporation governed under the CBCA has the same status.[4] A bank may carry on business throughout Canada.[5]

A bank may not carry on any business or exercise any power that it is restricted by the Act from carrying on or exercising, or exercise any of its powers in a manner contrary to the Act.[6] Similarly, a corporation governed under the CBCA may not carry on any business or exercise any power that it is restricted by its articles from carrying on or exercising, nor can the corporation exercise any of its powers in a manner contrary to its articles.[7] For a bank, its letters patent function like the articles of a corporation governed under the CBCA. The shareholders of a CBCA corporation may control its activities through provisions inserted in the corporation's articles. For a bank, the requirements of the Act are in effect deemed to be part of its letters patent.

Subject to the Act, a bank may not engage in or carry on any business other than the *business of banking* (italics added, see below) and *such business generally as appertains thereto* (italics added, see below).[8] For greater certainty, the business of banking includes: (a) providing any financial service; (b) acting as a financial agent; (c) providing investment counselling services and portfolio management services; and (d) issuing payment, credit or charge cards and, in cooperation with others including other financial institutions, operating a payment, credit or charge card plan.[9]

In addition, a bank may: (a) hold, manage and otherwise deal with real property; (b) provide prescribed bank-related data processing services; (c) outside Canada or, with the prior written approval of the Minister of Finance (Canada) (the "**Minister**") in Canada, engage in specified information service activities; (d) with the prior written approval of the Minister, 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 for specified activities (collectively, with the items described in (c), the "**Information Technology Activities**"); (e) engage, under prescribed terms and conditions, if any are prescribed, in specialized business management or advisory services; (f) promote merchandise and services to the holders of any

[3] Act, Subsection 15(1).
[4] CBCA, Subsection 15(1).
[5] Act, Subsection 15(3). A corporation governed under the CBCA has the same power: CBCA, Subsection 15(2).
[6] Act, Subsection 15(2).
[7] CBCA, Subsection 16(2).
[8] Act, Subsection 409(1).
[9] Act, Subsection 409(2).

payment, credit or charge card issued by the bank; (g) engage in the sale of certain types of tickets; (h) act as a custodian of property; and (i) act as receiver, liquidator or sequestrator.[10]

Specifically, the Information Technology Activities include the following: (a) collecting, manipulating and transmitting: (i) information that is primarily financial or economic in nature; (ii) information that relates to the business of a "permitted entity", as defined in the Act; or (iii) any other information that the Minister may, by order, specify; (b) providing advisory or other services in the design, development or implementation of information management systems; (c) designing, developing or marketing computer software; (d) designing, developing, manufacturing or selling, as an ancillary activity to any activity referred to in any of subparagraphs (a) to (c) that the bank is engaging in, computer equipment integral to the provision of information services related to the business of financial institutions or to the provision of financial services; and (e) with the prior written approval of the Minister, developing, designing, holding, managing, manufacturing, selling or otherwise dealing with data transmission systems, information sites, communication devices or information platforms or portals that are used: (i) to provide information that is primarily financial or economic in nature; (ii) to provide information that relates to the business of a permitted entity; or (iii) for a prescribed purpose or in prescribed circumstances.[11]

Except as authorized by or under the Act, a bank may not deal in goods, wares or merchandise or engage in any trade or other business (the "**Commercial Dealing and Trading Prohibition**").[12] The Act contains other restrictions on the activities of a bank; for example, no bank may act in Canada as: (a) an executor, administrator or official guardian or a guardian, tutor, curator, judicial advisor or committee of a mentally incompetent person; or (b) a trustee for a trust.[13]

The Business of Banking

Section 409 of the Act uses the phrase "*business of banking*"; however, the meaning of the phrase is not defined in the Act:

> "No certain definition [of banking] has emerged from the law. Indeed, the current judicial consensus is that certain definition may not be possible. Thus, Lord Denning M.R. has remarked that, 'Like many other beings, a banker is easier to recognize than to define. And Monnin J.A. has stated that, '[T]here is no exact definition of a banker or a bank.'
>
> There are a number of obvious reasons for this state of affairs. First, banking appears to consist of a bundle of activities rather than one unique activity. Secondly, these activities vary in time and place, and currently are expanding and changing at an apparently unprecedented pace. Thirdly, these activities are not exclusive to or peculiar to those who call themselves 'bankers', but are also carried on by a variety of other financial and non-financial institutions. Indeed, it is not at all clear any

[10] Act, Subsection 410(1).
[11] Act, Subsection 410(1)(c), (c.1). These provisions were incorporated into the Act in 2001 (2001, c.9, s.100).
[12] Act, Subsection 410(2).
[13] Act, Subsection 412.

> more that 'banking' is a discrete and distinctive human activity, as is medicine, engineering or law."[14]
>
> "'Banking' is a term of 'notoriously difficult' meaning in the law because, for almost 200 years, the business of banking has comprised an ever-growing group of financial services. The transition has been both steady and spectacular from the 17th century goldsmiths accepting deposits of bullion and honouring drafts as an accommodation to their wealthy customers, to the present day internationally active financial conglomerates that we know as modern banks. Some of the bank's current powers are historically associated with bankers (or evolved from services long accepted as 'banking'); some are newly authorized by statute; and inevitably, from time to time some are in dispute, as bankers continue to innovate, or to encroach on the traditional domains of other branches of the financial services sector by offering new services in direct competition with them…"[15]

In *Central Computer Services Ltd. v. T.D. Bank* ("**Central Computer Services Ltd.**"),[16] the Manitoba Court of Appeal held that automated banking services fell within the "business of banking". In examining the meaning of the phrase, O'Sullivan J.A., speaking for the court, made the following observation:

> "It is appropriate to note the view of Salmon J. in *Woods v. Martins Bank Ltd*... in a case where a bank tried to get out of responsibility for financial advice on the ground that the giving of the financial advice is not part of the business of banking… 'In my judgement, the limits of a banker's business cannot be laid down as a matter of law. The nature of such a business must in each case be a matter of fact and, accordingly, cannot be treated as a matter of pure law. What may have been true of the Bank of Montreal in 1918 is not necessarily true of Martins Bank in 1958'…
>
> I am not sure I would go as far as Salmon J. in treating the matter as purely one of fact. But I agree with his approach that the answer to the question 'Is this banking business or business that pertains to banking?' must be looked at in the light of all the facts, including the current practices of reputable bankers here and abroad and the custom and understanding of the business community, embracing what was in former times called the law merchant."[17]

The Supreme Court of Canada also considered the phrase in *Canadian Pioneer Management Ltd. v. Labour Relations Board of Saskatchewan* ("**Pioneer**").[18] After an extensive review of domestic and international cases and a variety of different legal tests, Beetz J. summed up his view as follows:

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[14] M.H. Ogilvie, *Canadian Banking Law*, Carswell, p. 2.
[15] B. Crawford, *The Law of Banking and Payment in Canada*, Canada Law Book, p. 8-1.
[16] (1980) 107 D.L.R. (3d) 88.
[17] *Central Computer Services Ltd.*, p. 223.
[18] (1980) 1 S.C.R. 433.

> "I agree with the contention which I quote from the factum of the Attorney General for New Brunswick that:
>
> 'Banking' involves a set of interrelated financial activities carried out by an institution that operates under the nomenclature and terms of incorporation which clearly identify it as having the distinct institutional character of a bank."[19]

Likewise, the meaning of "*such business generally as appertains thereto*" is not defined in the Act:

> "The Bank Act's addition of [business generally as appertaining to] the business of banking is probably intended to bring in any ancillary or necessarily incidental activities that the banks may wish to carry on in furtherance of, or to facilitate their banking business. The dictionary meaning of 'appertain' is 'belonging to, as part to the whole … or as an attribute or function'. If that were permitted to govern, the inclusion of 'appertaining' in s. 409(1) would add nothing. Therefore, I think that the legal meaning, in the context of the *Bank Act* is somewhat broader; perhaps 'reasonably incidental to' catches the right sense."[20]

With these terms not being defined, it is possible (necessary) to interpret the Act differently through time, in order to accommodate changing circumstances.

The Commercial Dealing and Trading Prohibition

The Commercial Dealing and Trading Prohibition has its origin in the fear of the monopoly power of the earliest banks:

> "Banks in the United States were patterned after the Bank of England, which was organized on different principles than the public banks on the continent, but whose charter restricted activities also. Prior to the establishment of the bank in 1694, private banking developed principally through an extension of the goldsmiths' businesses. The advantages provided by the public banks on the continent had been well-known in England, but the example was not adopted.
>
> The Bank of England was chartered to extend credit to the government at a relatively low rate of interest. It was granted a corporate charter by Parliament. The organizers of the bank agreed to lend the entire capital of the bank (£1,200,000) to the government at a rate of 8 percent, well below the rate it would otherwise have had to pay. They received authority to conduct a banking business, which enabled them to issue promissory notes payable on demand.
>
> A corporate charter in 1694, prior to general incorporation laws, constituted a delegation of public functions to private individuals. It was not unusual in England,

[19] Pioneer, p. 465.
[20] B. Crawford, *The Law of Banking and Payment in Canada*, Canada Law Book, p. 8-43.

> and elsewhere, for governments to make such delegations to provide transportation, water, and education; to collect taxes; and to fund mercenary armies. In English law, the charter was a grant of a franchise by a sovereign authority, that is, a 'privilege' to run a specific enterprise or to trade in a particular area for a specified period of time. Each was a product of negotiation which was perceived as resulting in a contractual relationship. The grant meant that the business could maintain its debts in the name of the corporation, which could sue and be sued on its own behalf, and continue to exist even though ownership and management changed. Judges inferred limited liability for stockholders from the fact that the corporation alone was liable for its debts.
>
> The grant, by its nature, implied 'monopoly privileges.' Governments typically required safeguards for itself [sic] and other commercial interests. Among other things, the activity of the corporation was defined and, thereby, limited in scope. The legal scholar Adolph A. Berle suggested that 'in theory this was probably designed to prevent corporations from dominating the business life of the time . . .' But definition also permitted the stockholders to know how their investment was used. Capital requirements were established to protect creditors against excessive leverage. Government took on a monitoring function.
>
> Monopoly grants provoked complaints. When the Bank of England was established, merchants complained about the possibility of unfair competition. A provision was added to the act establishing the bank, restricting its activities.
>
> 'And to the intent that their Majesties subjects may not be oppressed by the said corporation by their monopolizing or engrossing any sort of goods, wares or merchandise be it further declared… that the said corporation… shall not at any time… deal or trade… in the buying or selling of any goods, wares or merchandise whatsoever…'"[21]

This is the direct source of the Commercial Dealing and Trading Prohibition.

Consistent with other provisions of the Act, the language of the Commercial Dealing and Trading Prohibition is ambiguous:

> "'Deal in' and 'engage in any trade or business' have not been defined by the Act. However, the courts appear to regard these phrases as denoting such concepts as to barter, to traffic, to buy and sell either wholesale or retail, or to buy and sell with a view to making a profit. In short, the statutory prohibition is against buying and selling by a bank in a manner which is completely separate and independent from the business of banking."[22]

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[21] Bernard Shull, *The Separation of Banking and Commerce in the United States: An Examination of Principal Issues*, OCC Economics Working Paper, 1999 – 1, pp. 9-11.
[22] M. H. Ogilvie, *Canadian Banking Law*, Carswell, p. 340.

The Commercial Dealing and Trading Prohibition has occasionally been judicially considered, for example, in *Laarakker v. Royal Bank of Canada*.[23] In that case, an Ontario court interpreted the Commercial Dealing and Trading Prohibition in the context of an arrangement whereby a photographer was permitted to take pictures of a bank's customers while in a branch. In finding no breach of the Commercial Dealing and Trading Prohibition, the court made the following observation:

> "…The cases cited indicate that where the question under consideration is whether an activity was, or was not, legitimately or properly a part of the carrying on of the bank's business, the central consideration is the purpose or object of the bank in engaging in the impugned undertaking…
>
> … In the light of these authorities, to the extent that they are applicable, it seems that in a consideration of the bank's purpose or object in the activities which are now under review lies the answer to the question before me.
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> If the purpose or object was, in essence, promotion or advertising, then it was, in my view, part of the business of banking and unobjectionable. It was nowhere contended that promotion or advertising was not a proper part of the banking business…
>
> If, on the other hand, the purpose or object [of the bank] was, in essence, to engage in the business of dealing in portraits, or to carry on the business of portrait photography, under the guise of promotion, then, in my view, it was not part of the business of banking and it was objectionable.
>
> On the agreed statement of facts, I have no hesitation or difficulty in concluding that the fundamental and essential purpose or object of the bank in being engaged in the impugned activities was promotion or advertising..."[24]

The Commercial Dealing and Trading Prohibition has also been considered by OSFI:

> "Because of the clause 'Except as authorized by or under this Act....' in subsections 410(2) and 539(2) of the Bank Act, the restriction in dealing in goods, wares or merchandise applies only in respect of dealings that do not constitute part of 'the business of banking and such business as generally appertains thereto'.
>
> Canadian courts have ruled that the concept of the business of banking, which includes providing any financial service, is not a static concept but evolves as the activities of banks evolve. The scope of the power that a bank may exercise has

[23] 31 O.R. (2d) 188; 118 D.L.R. (3d) 716. See also *Molsons Bank v. Kennedy* (1879), 10 R.L.O.S. 110 and *Northern Crown Bank v. Great West Lumber Co.* (1914), 17 D.L.R. 593.
[24] *Laarakker,* Canli version, pp. 7 – 10.

> been assessed in light of the activities that banks generally undertake, both within and outside Canada."[25]

In summary, the origin of the Commercial Dealing and Trading Prohibition is found in the political arrangements involved in the establishment of the earliest Anglo-American banks: in exchange for the granting of their charters, banks were prohibited from infringing on general commercial activities. In its modern context, this means nothing more than banks cannot engage in business activities which have no connection with the provision of some kind of financial service. Judicial and regulatory interpretation acknowledges that the business of banking is an evolving phenomenon. As a result, commercial activities tied to that business by definition must be permitted to evolve.

Clarifying the Fintech Business Powers of a Bank

We submit that an attempt to clarify the fintech business powers of a bank should be focused foremost on a modern interpretation of section 409 of the Act. Simply put, technological innovation and implementation (in and of itself a fluid and ever-changing activity) should now be regarded as part of the *business of banking*, or at a minimum, *business generally as appertains thereto*. Fintech business powers of a bank should not be regarded as an additional permitted activity under section 410 of the Act. In other words: without fintech, there would be no modern business of banking, being inextricably interwoven into its current practice and future development. Fintech is now fundamental to banking, whereas other items enumerated in section 410 of the Act (e.g. selling tickets or acting as a receiver, liquidator or sequestrator) have not achieved that status.

Therefore, on the basis that fintech activities are properly included in the powers of banks under section 409 of the Act, we would suggest that the language regarding Information Technology Activities, already over 16 years old, should be removed from section 410 of the Act. Not only is the activity no longer suited for inclusion in that section of the Act; the terminology is arguably outdated in any event. Additionally, it is unlikely that any new language added now in the Act would serve its intended (or a useful) purpose five years from now, let alone 10 or 15 years in the future. The language of the Consultation Paper demonstrates the reality of the situation: given the pace of technological development, what is "emerging" financial technology today will probably be commonplace, if not outdated, in a relatively short period of time. It is improbable that the Act could keep pace with this development.

Moreover, we would argue that the utilization of fintech by a bank in furtherance of its business is clearly not an activity caught by the Commercial Dealing and Trading Prohibition. As noted above, the historic source of this provision of the Act is found in competition concerns: merchants afraid that banks, enjoying special economic privilege, would use that privilege to directly compete with those merchants. The cases, and OSFI's own guidance, recognize the statutory concern as one of intent: a bank can undertake an activity as long as it promotes its banking business, and not because it wants to be in another business, as well as its banking business.

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[25] OSFI Ruling - *Physically Settled Commodity Trading*. No: 2004-05. See also OSFI Advisory – *Business and Powers – Ownership Interests in Commodities.* No: 2013-01.

If the regulatory concern is a competition one, as a significant and robust fintech sector currently exists throughout the world and outside of the control of the Canadian banking system, and that sector will inevitably grow, that concern, from a practical perspective, should be alleviated. In any event, competition regulators in Canada have a history of influence over activities in the banking sector.[26] Those regulators would be able to monitor competition concerns related to the banking sector's effect on the fintech sector.

If the regulatory concern is a prudential one, then we would offer two observations. The first is that it is not obvious why fintech activity should be regarded as any riskier than any of the other activities currently carried on by Canada's banks. We would argue that it is less risky (to the extent, at least, that the fintech activity does not involve any form of financial intermediation). The second is that regulators have a number of powerful tools to manage the affairs of Canada's banks, including a more stringent capital adequacy regime. Capital adequacy rules could be deployed, if necessary, to control bank fintech activities.

Facilitating Fintech Collaboration

Consistent with our views on clarifying the fintech powers of banks, we submit that section 468 of the Act should be amended to permit banks to control, or acquire or increase a substantial investment in, an entity engaged in fintech activity. This position is consistent with our view that fintech should now be regarded as an activity covered under section 409 of the Act (being the "business of banking" or alternatively "such business generally as appertains thereto").

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We appreciate the opportunity to provide these comments regarding the Consultation Paper. Should you wish to discuss these comments, please contact the undersigned.

Sincerely,

Mark Wilson

[26] See for example: (i) Competition Bureau's Letter to Financial Institutions - Duality and Dual Governance of Credit Card Networks in Canada: November 8, 2008; (ii) Competition Bureau Statement Regarding the Acquisition of Ally Canada by Royal Bank: February 8, 2013; (iii) Competition Bureau's Letter to the Royal Bank and Bank of Montreal: December 11, 1998; and (iv) Competition Bureau's Letter to The Toronto-Dominion Bank and Canada Trust: January 18, 2000.