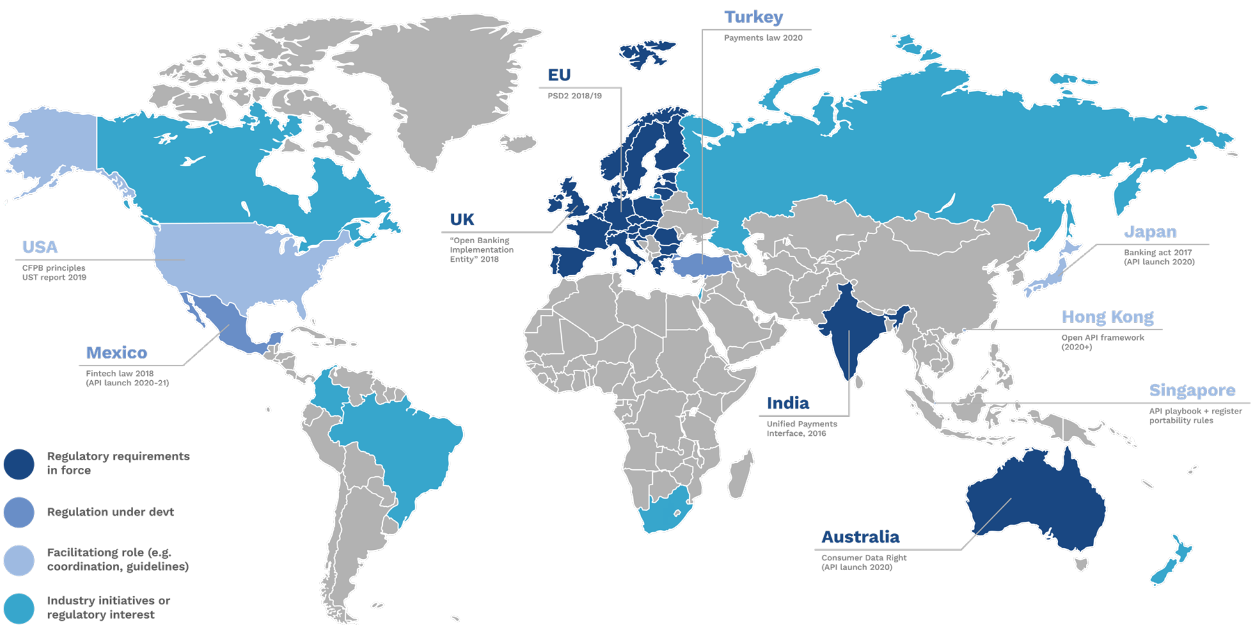
4 Trends That Could Make Canada a Leader in Financial Innovation

FISPAN

It’s no secret that Canada is a laggard in technological innovation. Companies in other countries spend more on research and development, own more patents and attract more private investment than domestic businesses do. This issue is particularly acute in the financial sector. According to a 2019 report from C.D. Howe, Canada’s financial sector contributes much less to overall productivity than its contemporaries do in other OECD countries. It blames a lack of investment in fintechs, too much regulation, particularly for financial startups that are subject to the same rules as the big banks, and barriers to entry for new lending and payment operations.

Approaches to Open Banking Regulation Around the Globe



Caption:

Different policy initiatives across jurisdictions have emerged, ranging from direct regulatory requirements (such as in the EU, UK, Mexico, Turkey or Australia) to market-coordination (Japan, Hong Kong), guidance (Singapore) and industry-led initiatives (New Zealand, Colombia). Source: BBVA, Open Banking Regulation Around the World.

Canada is also falling behind because the country's banks aren't willing to push the envelope on innovation in the way institutions in other countries do. Deutsche Bank, for instance, is making big investments in the fintech space. It recently bought 4.9% of Deposit Solutions, a company that allows banks to offer their clients products from third-party fintechs. JPMorgan has invested millions to support the growth of fintech startups, too.

While some Canadian institutions are paying more attention to digital innovation than they have in the past, most notably RBC, which has invested in financial tech, though mostly its own, they're not so far behind that can't catch up – and even become leaders in this space.

However, if Canada's banks are going to become global financial innovators, they need to be more open-minded when it comes to working with fintechs and embrace four key trends. They include open banking, authentication and digital identification, payments modernization, and embedding financial services within other applications. Becoming a tech powerhouse can also only happen if banks embrace all these trends at once.

In this white paper, we break down each trend and look at how banks can adopt each one.

1. Open banking

Out of these trends, open banking may be the most important in that it ties everything else together. As we've detailed in the past, open banking is the practice of sharing financial information with third-party fintechs and banks, typically through APIs. By having a freer flow of information between these parties, both banks and fintechs could develop new apps and services for their customers.

To put it another way, open banking, if done right, will revolutionize the way institutions interact with their clients and it will allow them to offer many more products. The key here, though, is data sharing. Banks must freely share client information with third-party companies, who can then use that data to create new financial experiences. While banks may be putting some of their market share at risk, they may also be able to gain more clients by partnering with a company that offers something the bank does not.

For example, entrepreneurs often have money in a variety of different accounts – with open banking the business owner could access all of their accounts in the same place. Why not allow your clients to see their entire financial picture within your app? There are fintechs that allow a company's enterprise resource planning (ERP) software to seamlessly connect with their bank account and instantly issue payments to vendors, rather than having to wait if the instructions they sent are readable by the bank's systems. There are many other use cases for open banking and plenty more that haven't even been dreamed up yet.

Unfortunately, Canada is already falling behind some other countries, such as the U.K. and Australia, where governments have mandated open banking and the sharing of customer information. However, adoption in these locales has been slow, while technical issues have made open banking difficult to implement. At some point, the Canadian government will follow suit and mandate open banking, but the sooner banks come on board – and some may get ahead of legislation and create better user experiences now – the better. Everyone should want to see open banking succeed, too. It will make it easier for a bank's business clients to operate, which then further increases economic innovation and competitiveness.

2. Authentication and digital ID

Of course, privacy is an important part of open banking, with PwC saying that privacy breaches, data security, cybercrime and fraud worry a lot of financial industry players. In order for data sharing to work, there needs to be a verification system that allows a bank to know that the company that wants to share its data with a fintech is legitimate. It helps to know that the third-party tech company is on the up and up as well.

Many industries rely on the Oauth protocol, which is a technology that allows users to log onto websites or applications with a single sign-on (SSO) and without needing to enter a password. For instance, a company might access their cloud-based accounting program by clicking on a Google or Facebook button – the program knows who it is because of the data that Google provides. This sort of verification system could be useful for banks to help authenticate which users or programs are trying to access their data.

However, banks don't need to reinvent the wheel. Canada already has a proven authentication and digital identification system in place called SecureKey. It's what Canadians use to log in to their MyCRA accounts. Most Canadian financial companies are already using this system – anyone logging into their

Canada Revenue Agency account online must use their bank card information to get in – and so there's no reason why it can't be used in other settings. SecureKey offers SSO, and, if used properly, it could allow developers and banks to stitch together new and powerful user and financial experiences.

3. Payments modernization

Along with all of this comes payments modernization. If financial data is going to be shared, and if money is going to move between various apps, programs and accounts, unified payment standards must be adopted. Some financial institutions are using the ISO 20222 format, which is a revolutionary messaging standard that makes it easier for computer systems and settlement networks to share payment-related information, but many have not moved to this format yet. Experts think they should.

"Treating (ISO 20222) as just another IT project would be a mistake – it is game-changing and signifies an opportunity for banks and corporates to improve operational efficiency and reassess existing business models," said Christian Westerhaus, head of cash products and cash management at Deutsche Bank, in one of its reports. "However, making the most of ISO 20022 requires a significant and complex migration, affecting not just core payments processing, but many other banking systems and departments."

One of the big benefits of ISO 20022 is the amount of data that can be embedded in every payment. The payment file itself might contain invoice numbers, information about the sender, such as the company's name and address, the account to deposit the money into and more. Payment modernization also allows money to flow between banks and company coffers in near real-time. Business owners won't have to wait five days for a cheque to clear anymore – which is always frustrating for a bank's client – as the institution will know where that payment has come from and immediately deposit the full amount into their customer's account.

The other benefit of payment modernization is that a bank's corporate customers will have access to a wider range of payment systems. They'll be able to interact with a fintech as easily as they can with their bank, while non-bank entities, such as a company's ERP provider or payroll company, will be able to create more interesting and relevant experiences, which the bigger banks can add into their own offerings. Banks should want to make their clients' lives better by, say, helping them better manage their cash flows through easier bill collecting. Like in retail, keep clients happy and they'll come back for more.

4. Financial services becoming embedded within applications

When the potential for open banking is fully realized, companies of all shapes and sizes will offer financial products to their customers directly from their apps or programs. You're already seeing some of this – e-commerce giant Shopify recently announced it's going to provide its merchants a no-fee, no-minimum balance business bank account so that they can keep their earnings in one place versus having to move their income into a traditional bank account.

If banks don't embrace open banking then other firms will take their place. The ones who have a fear of missing out, and they all should, need to be thinking more broadly about how they can offer products in a more distributed world. Imagine if a bank offered account services to an ERP provider – a business owner might keep their money with the software company, but the bank would earn management fees on money they wouldn't have otherwise had. At the same time, the ERP provider, which now has access to their client's bank account, might allow their client to pay employees every day instead of every two weeks, which could help with more real-time cash flow management. What's more, smaller companies could offer their own credit cards or provide their own financing for a product.

Start planning now

Naturally, all of this may sound a little scary for banks, because it will cost money to shift to open banking and you may lose customers to other companies (like Shopify). But rather than sit back and wait for the banking landscape to shift, be proactive and offer new user experiences so that clients don't get tempted to go elsewhere. Consider partnering with fintech firms and other companies to offer products to new markets.

Banks don't need to start from scratch either – a company like FISPAN is building innovative APIs to help banks and fintechs speak to one other. It's working with a number of banks globally to help them create an ecosystem of complimentary apps and to provide better services for their clients. FISPAN worked with JPMorgan, for instance, to create a NetSuite plugin that allows their business customers to pay vendors directly through their ERP system. Canadians want this kind of functionality, with companies like Moneris, Visa, Mastercard and others trying to motivate this country's banks to adopt more innovative thinking.

Ultimately, the sky's the limit in terms of what banks can offer, but financial institutions need to have an open mind and be willing to reimagine the way they operate. That may seem like a big ask, but the way businesses bank is changing and so banks need to offer their clients the right financial tools to compete in a more globalized world. At some point, Canada's system will change. The question though is whether the country will have to play catch-up, which could significantly hurt productivity and innovation in the meantime, or whether they can see open banking for what it is – a new opportunity to build stronger client relationships and better products – and lead the way.

Interested in learning more?

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