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• WHY WE DON'T HAVE TWENTY-FIVE YEAR MORTGAGES IN CANADA •

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INTRODUCTION

A young couple have found the house of their dreams and start looking for a mortgage that they can pay off over 25 years. Every mortgage lender they talk to is willing to offer them a mortgage with a payment schedule that amortizes over 25 years, but none of them are willing to offer a mortgage that fully matures in 25 years. In fact, very few of them are willing to offer a mortgage that matures more than five years from the mortgage date. Why can't this couple find what they are looking for?

Sometimes, a local commercial practice becomes so entrenched that it is difficult to imagine the practice being any other way. Such is the case with the predominant practice in Canada of maximum residential mortgage terms of five years even though amortization periods generally range from 25 to 40 years.[1]

One of the major impediments to the development of a market for Residential Mortgage Backed Securities ("RMBS") in Canada that are not guaranteed by Canada Mortgage and Housing Corporation ("CMHC")[2] (sometimes referred to as "private label" RMBS) is the fact that all mortgages in an RMBS mortgage pool will typically mature within five years, usually with a large balance due on maturity (sometimes referred to as a "balloon payment"). This mismatch between amortization period and maturity creates a need to re-finance or

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renew the outstanding balloon payment at maturity. Prospective investors in Canadian RMBS as well as prospective US-based rating agencies are concerned about what could happen at maturity if real estate values have significantly decreased. There is a risk that the mortgagee will choose not to renew a loan if the fair market value of the mortgaged property is less than the principal amount and accrued interest of the mortgage loan and that the mortgagor may not be able to find a new lender. At that point mortgage enforcement may be necessary and investors would suffer losses.

This "balloon risk" or "renewal risk" is usually met with the argument that in the case of a performing mortgage, the lender would always have an incentive to continue to receive mortgage payments by offering a series of short mortgage renewals in the hope of restructuring the mortgage and maximizing its recovery. That may nearly always be true if the lender still had an economic stake in the mortgage. However, in RMBS, the mortgage lender has transferred the risk of ownership to investors keeping only a relatively small economic investment in the RMBS pool for itself. Typically this interest is represented by the most junior tranche of ownership certificates that absorb initial losses on an RMBS pool. Once losses on the pool exceed this relatively small "first loss tranche", the lender may no longer be incentivized to continue to extend mortgage loans, unless there is value to the lender in maintaining the customer relationship even where the mortgage is under water.

There could also be legal impediments to a lender renewing a mortgage loan if the underlying property value has decreased significantly. By law, residential mortgages underwritten by a federally regulated financial institution for the purpose of purchasing, renovating or improving a property must be insured if their loan to value ratios are greater than 80 per cent.[3] The loan to value calculation is to be made "at the time of the loan". If a renewal must be a new loan (notwithstanding that it continues to be secured by the same mortgage document), and if the value of the mortgaged property has decreased since the time of the origination or last renewal, then a federally

regulated financial institution may find itself unable to renew the loan if the loan to value ratio would exceed 80 per cent at the time of renewal unless the mortgage was insured.

Another problem for the rating agencies is what would happen if the lender is unable to continue to grant mortgage renewals. If real estate values drop significantly, mortgage lenders would be under stress and some would fail. If a mortgage lender becomes insolvent, it could likely continue to offer mortgage renewals to its customers if it was in the process of making a proposal to restructure its debt and continue or sell its business. However, if restructuring or sale efforts fail, a lender in liquidation could well be constrained in its ability to offer mortgage renewals, even for performing mortgages. Since rating agencies are generally asked to provide a rating of AAA (sp) on the top tranche of an RMBS transaction (typically comprising 80-90 per cent of all RMBS backed by a mortgage pool), this rating may not be achievable where mortgages are derived from mortgage lenders who are not highly rated themselves since the prospect of recovering balloon payments over time may depend upon the ability of the original lender to offer renewals at maturity.

When a mortgage lender becomes insolvent, stories always surface about borrowers who have struggled to faithfully pay down their mortgage for five years, only to lose their homes when they are unable to renew or refinance their mortgages. Facilitating a shift to longer mortgage maturities would serve to better protect these unfortunate individuals.

MORTGAGES IN OTHER COUNTRIES

Other countries, such as the United States, the United Kingdom and Australia, that have some history of private label RMBS, do not have the refinancing risk present in Canada because their mortgages may be for longer terms.

Mortgages in the United States

In the United States, the standard mortgage is the 30-year fixed-rate open mortgage.[4] A 2006 report by the Federal Reserve Bank of San Francisco suggests that this practice arose to "avoid the refinancing risk that contributed to the banking crisis during the Great Depression".[5]

Due to the prevalence of the 30 year fixed-rate open mortgage, lenders face an increased risk if interest rates fall. As a result, they often compensate by charging higher interest rates to begin with. Patrick Lawler, the chief economist of the US Federal Housing Finance Agency, suggests that US borrowers pay at least an extra 0.25 per cent to 0.50 per cent in interest rates in exchange for the option of prepayment without penalty.[6] It is worth noting that in the United States, unlike Canada, interest on residential mortgages is tax deductible, resulting in a lower incentive to prepay.

The *Dodd-Frank Act*[7] bans prepayment penalties on all loans except fixed-rate loans with an interest rate that does not exceed the conventional rate by more than 1.5 per cent.[8] For these loans, prepayment penalties are limited in amount and duration, and borrowers must be offered a loan without a prepayment penalty. First, a prepayment penalty is only allowed during the first three years after the loan is consummated.[9] Second, there is a cap on the dollar amount of the prepayment penalty. For the first two years after the loan is consummated, the penalty cannot be greater than 2 per cent of the amount of the outstanding loan balance.[10] For the third year, the penalty is capped at 1 per cent of the outstanding loan balance.[11] Finally, before the mortgagor enters the mortgage, the lender must offer an alternative loan that does not include a prepayment penalty. In doing so, the lender must have a good faith belief that the consumer likely qualifies for the alternative loan.[12]

Mortgages in the United Kingdom

The majority of mortgages in the United Kingdom are variable rate, fully amortizing, level pay mortgages with a maturity of 20 to 25 years.[13]

Prepayment penalties in the United Kingdom are governed by contract law. At an early stage, before the mortgagor accepts the mortgage contract, the offer

must contain a tariff of charges for the mortgage contract, including any prepayment penalty that the mortgagor might be obliged to pay.[14] More specifically, the disclosure on the early repayment charge must meet the following requirements: (i) it must be expressed as a cash sum; and, (ii) it must be a reasonable pre-estimate of the cost to the lender of the customer repaying early.[15] Furthermore, any illustration that depicts an early repayment charge must include an explanation of the charge, the basis on which it is calculated, the maximum charge under the contract as a cash sum, and information about transferring mortgage arrangements.[16] Finally, if the charge is to be calculated in accordance with a formula set out in the mortgage agreement, it should represent a reasonable pre-estimate of the refinancing cost to the lender of the loan being repaid early.[17] Practically speaking, the prepayment penalty in the United Kingdom is between 2 per cent to 5 per cent of the amount being repaid.[18]

Mortgages in Australia

The most popular mortgage product offered in Australia is the three year, variable mortgage.[19] Variable mortgages account for approximately 85 per cent of all mortgages in Australia.[20] Both variable rate and fixed rate mortgages can be taken for a maximum term of 30 years, with the typical loan term being 25 years.[21] On July 1, 2011, the Government of Australia officially banned mortgage exit fees for variable rate mortgages. However, exit fees for fixed rate mortgages still exist in Australia.[22]

HOW DID WE GET HERE?

The situation in Canada has resulted from a combination of a 130-year old statute and a 30-year Supreme Court of Canada decision. Section 10(1) of the *Interest Act* (Canada) reads as follows:

> "10(1) Whenever any principal money or interest secured by mortgage of real estate is not, under the terms of the mortgage, payable until a time more than five years after the date of the mortgage, then, if at any time after the expiration of such five years, any person liable to pay or entitled to redeem the mortgage tenders or pays, to the person entitled to receive the money, the amount due for principal money and interest to the time of payment, … together with three months further interest in lieu of notice, no further interest shall be chargeable, payable or recoverable at any time thereafter on the principal money or interest due under the mortgage."[23]

Section 10 was first enacted by Parliament in 1880.[24] Parliamentary Debate from the time indicates that this provision was intended to remedy the problem of farmers being locked into long-term mortgages at high interest rates and being subjected to large penalties when they sought to prepay.[25] As noted by the Supreme Court of Canada in its seminal decision dealing with Section 10, *The Royal Trust Company v. Potash ("Royal Trust")*,[26] Section 10 was enacted "in response to conditions prevailing a century ago when farmers were locked into long term mortgages at exorbitant interest rates by money lenders who were "eating up the vitals of the yeomanry of the Country."[27]

Approximately ten years after Section 10 was first enacted, subsection 10(2) was added to exempt the application of that section in respect of any mortgage "given by a joint stock company or other corporation".[28] A few years ago, this exemption was expanded to cover additional business organizations.[29] However, as it relates to mortgages given by individuals, the statutory provision has remained intact for over 130 years.

The Supreme Court of Canada considered the interpretation of Section 10(1) of the *Interest Act* in Royal Trust.[30] The Court effectively held that a renewal agreement or extension agreement re-dates the mortgage for purposes of Section 10(1) of the Interest Act so as to commence a new five-year maximum lock-in period.

In that case, the mortgagor had entered into a five year renewal agreement after an initial five year term plus a one year renewal. The mortgagor wished to prepay his mortgage in full about two years into the five year renewal.

The argument of the mortgagor was straightforward. There was only one mortgage. The renewal may have changed the terms of the mortgage but it was still the same mortgage on the same property. To find that it was a different mortgage would have required the mortgagee to search title again to determine again if there had been any intervening mortgages or liens. The phrase "date of the mortgage" in Section 10(1) is unambiguous since there is only one mortgage. As a result, Section 10(1) should be given its plain meaning; namely, that for any mortgage having a term of greater than five years, the mortgagor would be entitled to prepay the mortgage at any time after the first five years subject to a maximum prepayment penalty of three months interest.

The argument for the mortgagee was that Section 10(1) should be given a liberal interpretation in keeping with then current commercial realities. Counsel submitted that the purpose of the section was to ensure that mortgagors were not "locked-in" to high interest rates for more than five years without an opportunity to re-negotiate terms. This would be done by reading "date of the mortgage" as "date of the mortgage as amended" so that the date of the renewal or extension became the new date of the mortgage.

As referred to in the Royal Trust decision, the Ontario Law Reform Commission, in a report in 1971 on the equivalent section of the *Mortgages Act* (Ontario), supported the interpretation suggested by the mortgagor:

> "Some lenders are of the opinion that the renewal represents a new agreement and that the five-year period must therefore be re-calculated from the date of renewal. … These views, however, ignore the facts that by the terms of the legislation the five year period runs from the date of the mortgage, in other words from the date that the conveyance to the mortgagee of the original mortgagor's interest was made, that renewal in this context merely alters the date for termination, and that if renewal truly effected a new mortgage contract there would be doubt as to whether priority for the principal debt over second and later encumbrances could be preserved."[31]

The Supreme Court of Canada opted for the alternative interpretation advocated by counsel for the mortgagee, that the purpose of Section 10(1) was not to require that a mortgage remains open after the first five years but to require that a mortgagor has the right to redeem his mortgage at least once every five years with no interest differential penalty. As noted by the Court,

> "In the late nineteenth century when the section was first enacted, the term of a mortgage and its amortization period coincided. Today this is seldom the case, most residential mortgages being for less than five years, but amortized over twenty or thirty years. This was a situation not envisaged by legislatures in the 1880's and 1890's. It would have made no difference therefore to the early draftsman whether the objective of section 10 was stated as being to make mortgages open after five years or to ensure that mortgages were never locked in for more than five years. … Both are equally consistent with Parliamentary intent and the only basis for choosing between them, it seems to me, is to ask which is more in keeping with common commercial practice."[32]

> So why can we not now have the best of both worlds: Have residential mortgages with maturity dates matching amortization periods with automatic resetting of interest rates and a right of the mortgagor to redeem without penalty at least every five years. That would satisfy the policy objectives of Section 10(1) (as found by the Supreme Court of Canada), would closely reflect current market practice and would satisfy concerns of US rating agencies and investors relating to refinancing risk if a mortgage matures every five years. The answer is that while the Supreme Court of Canada did give Section 10(1) a broad and liberal interpretation it was not that broad and liberal. The "date of the mortgage" for purposes of Section 10(1) is only changed when there is (i) a renewal agreement (not just any amending agreement), (ii) which deems the date of the mortgage to be the date of maturity of the existing loan, and (iii) the renewal term itself does not exceed five years. A cautious interpretation of the Royal Trust decision leads to the conclusion that in any other circumstance where the original mortgage term exceeds five years, the mortgagor would be entitled to pay off the mortgage any time after the first five years without an interest differential penalty. The conclusion of the court on these points are set out as follows:

> "1. The purpose of Section 10(1) of the *Interest Act* … is to ensure that mortgagors have the right to pay off their mortgages at the end of each five-year period. They cannot be "locked in" for more than five years.

> 2. Where the original term of a mortgage exceeds five years, the mortgagor has the right to pay it off at the end of five years in compliance with the section.
>
> 3. Where the original term of the mortgage is for five years or less and the term is extended by agreement beyond the five-year period (the "date of the mortgage" remaining unchanged), the mortgagor has the right to pay it off at the end of five years.
>
> 4. Where a mortgagor elects not to exercise his right under Section 10(1) but instead enters into an otherwise valid and enforceable renewal agreement which "deems" the date of the original mortgage to be the date of maturity of the existing loan, and the term of the renewal agreement does not itself exceed five years, he cannot pay off the mortgage until the end of the five year renewal period."[33]

As a result, the only way to make use of the liberal interpretation in the Royal Trust decision is for the original mortgage loan to mature and for it to be renewed. A twenty-five year mortgage that provides for a right of redemption every five years (and consequently resets the interest rate at least every five years) would not fit within the Royal Trust decision and would simply be pre-payable by the mortgagor at any time after the fifth anniversary with a maximum penalty of three months' interest.

PROPOSED AMENDMENT TO SECTION 10

In order to achieve the best of both worlds, it will be necessary to amend Section 10 of the *Interest Act* to explicitly allow for five year lock-in periods other than through a renewal, regardless of the maturity date of the mortgage, while still permitting the practice of extending mortgages through renewal. It is important to look at the purpose of the section as allowing mortgagors to redeem every five years, regardless of the maturity date of the mortgage, but to also allow the parties to a mortgage to waive this right and to re-set the interest rate under the mortgage for up to another five years.

The clearest way to redraft Section 10(1) of the *Interest Act* would be to do so in a way that simply provides that the mortgagor of a residential mortgage is to have the right to redeem the mortgage at least every five years, regardless of the term of the mortgage, with a penalty capped at three months' interest. I propose the following modest redraft of Section 10(1):

> "Any person liable to pay or entitled to redeem a mortgage of real estate, other than persons described in subsection (2), shall have the right to redeem such mortgage on the fifth anniversary of the date of such mortgage and at any time thereafter by tendering or paying to the person entitled to receive the money the amount due for principal and interest to the time of payment together with three months' further interest in lieu of notice; provided that the person liable to pay or entitled to redeem such mortgage may from time to time agree to waive such redemption right in a written renewal or amendment of the terms of such mortgage for up to five years from the date of such renewal or amendment."

This redraft shifts the focus of the section to the waiver of the redemption right for another five years, not to the form in which such waiver takes (renewal or amendment).

If a mortgagor under a 25-year mortgage waives his or her redemption right then the mortgage does not mature. It continues to be outstanding and the interest rate under the mortgage will be whatever the parties agree that the interest rate should be. Presumably, the original mortgage terms could provide that failing agreement on a re-set interest rate, the interest rate would automatically become a prime rate or floating rate mortgage (such as the lender's quoted variable rate, perhaps adding an additional spread). In this situation, the mortgage would become an open mortgage (pre-payable at any time without an interest differential penalty); however the re-investment risk should be minimal if the mortgage has become a floating rate mortgage. Importantly, the mortgagor would not be required to make a balloon payment at the end of five years.

A SECOND PROPOSAL FOR SECTION 10

If Parliament decides to amend Section 10 of the *Interest Act*, I suggest that it should also consider whether to extend the five year interest re-set provision to a longer period, such as ten years.

This would enable borrowers to lock-in their interest rates for longer periods of time and would provide more choice in the marketplace.

Since mortgage lenders tend to match the terms of their assets and liabilities, and since Canada Deposit Insurance Corporation will only insure deposits for up to five years,[34] deposit taking financial institutions will likely continue to favour mortgages having terms of five years or less and use the current practice of renewing every five years, unless they were interested in originating mortgages for securitization. However, other mortgage lenders may be more flexible in terms of offering longer term mortgages if they were able to recover a full interest differential prepayment penalty. Mortgages with longer interest rate re-set periods could result in private label RMBS with longer expected durations and make this investment product more attractive to certain institutional investors.

Although ten year fixed rate mortgages will not be suitable for some borrowers they would be suitable for others. They would shelter borrowers from the impact of rising interest rates for longer periods. A competitive market should mitigate the impact of the prospect of steeper prepayment penalties by permitting greater amounts of penalty free annual prepayments and portability of mortgages upon a sale of the property. Consumer protection laws have come a long way since the 1880's and the level of cost of borrowing disclosure currently required of mortgage lenders ensures that borrowers receive a better explanation of the costs and benefits of locking in their mortgage rates for longer periods.

CONCLUSION

The five year residential mortgage term that we are used to in Canada is not common outside of Canada. This product's renewal risk is an impediment to the development of a private label RMBS market in Canada and, although they are generally not conscious of it when they take out their mortgages, it is a risk to borrowers as well. The only way to address this refinancing risk would be to facilitate the introduction of a product that does not mature every five years but provides for an interest rate reset and penalty free right of redemption at least every five years. This can only be achieved through an amendment to Section 10(1) of the *Interest Act* (Canada). If Parliament decides to amend Section 10(1), it should also consider lengthening the five year redemption right to a ten year redemption right as this would make it easier for lenders to offer longer term fixed rate mortgages to borrowers who would prefer a longer interest rate lock-in period.

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Sharon Au *recently completed her articles at Torys LLP and will be returning as a corporate associate in September 2016.*]

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1 Until 2006, the maximum length of a mortgage that CMHC would ensure was 25 years. In the 2006 federal budget, the Government of Canada increased the maximum amortization period for a CMHC mortgage to 40 years. In October 2008, the maximum amortization period went down to 35 years. In January 2011, the maximum amortization period went down to 30 years. In 2012, the maximum amortization period for insured mortgages went down to 25 years. There are no limitations on amortization periods for uninsured mortgages.

2 CMHC currently operates two securitization programs. The first involves the issuance of mortgage-backed securities under the *National Housing Act* (Canada), R.S.C. 1985, c. N-11 ("NHA MBS") by issuers authorized by CMHC pooling insured mortgages and issuing NHA MBS specifically backed by these mortgage pools. The second involves

the issuance by Canada Housing Trust — a special purpose entity sponsored by CMHC — of term bonds, called Canada Mortgage Bonds, which are secured by NHA MBS provided by approved sellers. Both NHA MBS and Canada Mortgage Bonds are guaranteed by CMHC.

[3] See the *Bank Act*, S.C. 1991, c. 46, subsection 418(1); *Trust and Loan Companies Act*, S.C. 1991, c. 45, subsection 418(1); *Insurance Companies Act*, S.C. 1991, c. 47, subsection 469(1); and the *Cooperative Credit Associations Act*, S.C. 1991, c. 48, subsection 382.1(1).

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[11] *Ibid.*

[12] *Ibid.*

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[23] *Interest Act*, R.S.C. 1985, c. I-15, section 10(1).

[24] See *Litowitz et al v. Royal Trust Company of Canada* (1996), [1996] O.J. No. 3816, 30 O.R. (3d) 579,(C.A.) at page 584.

[25] House of Commons Debates, March 31, 1880, page 954.

[26] [1986] S.C.J. No. 58, [1986] 2 S.C.R. 351.

[27] *Supra*, note 26 at page 358.

[28] *Supra*, note 24 at page 584.

[29] *Prescribed Entities and Classes of Mortgages and Hypothecs Regulations*, SOR/2011-230, section 1.

[30] *Supra*, note 7.

[31] *Supra*, note 26, at page 361.

[32] *Supra*, note 26, at page 368.

[33] *Supra*, note 26, at page 374.

[34] *Canada Deposit Insurance Corporation Act*, Schedule 2, R.S.C. 1985, c. C-3.

• REGULATION OF FINANCIAL TECHNOLOGY: BRACING THE NEW FRONTIER •

Alena Thouin

INTRODUCTION

The emergence of financial technology has been the "it" word of the financial services industry over the last few years. These small, nimble, entrepreneur driven companies have been called disruptors, innovators, pioneers and other terms that generally make most lawyers and regulators excited and nervous at the same time. Much has been said of their effect on the banking landscape and many articles have been written on fintech's impending invasion on the longstanding steady world of staple financial services. The specific innovation categories include disruptions on consumer lending, payments, analytics and insurance. In Canada, this has created a particular anxiety in what is a very regulated and established world of banking. The disruptive nature of fintechs has not been dismissed as a fad and their increasing interaction directly with customers began to raise both financial and regulatory questions. Many financial institutions have radically adjusted the playbook, creating innovation labs, technology hubs, and generally supporting Canada's leading universities in growing new talent in this area.

As a result of this rapid evolution, it became apparent very quickly to most legal professionals in this area that the game is changing. Lawyers in the financial services industry have been busy trying to grapple with these emerging ideas and associated legal issues. Fintech revolution has given a rise to an intersection of regulatory, commercial, and technology law. Lawyers in house and in private practice within the financial services industry have been attempting to support their corporate clients in development of the new playbook while trying to advise on issues for which there is no legislation and developed case law. The existing legislation in the financial services industry both provincial and federal has never contemplated the types of products and consumer interaction that are being directly marketed to the consumer by the new industry entrants. At the same time, the regulators across the globe began to develop different approaches in an attempt to keep up. The challenge in developing a regulatory framework in this area has been mainly trying to match up the longstanding regulatory principles to what is essentially a moving target of technology,

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products and services all while maintaining market competitiveness for new and existing market players. Issues such as AML/ATF, consumer disclosure, cyber security, payments, and risk management have made it challenging for regulators to take a hard line stance that would stifle innovation and keep their nation out of the game. However, all regulatory authorities' mandate includes consumer protection and maintaining stability of the system. As both small and large financial institutions are partnering with new market entrants, they are increasingly looking to the regulatory authorities for clarification of expectations to ensure client protection and levelling the playing field.

1. REGULATORY INITIATIVES

In the last few years, regulatory authorities across the world have begun to develop different approaches to support and risk-manage the new entrants. As a result, these approaches have been differing in focus and intensity. Below is a quick tour of what has been happening with major regulators across the world:

A. Financial Conduct Authority ("FCA") – UK

The FCA has been on the forefront of fintech support and regulation. They have been pioneering what is essentially a flexible and "regulator lite" approach to fintech regulation. In October 2014, FCA launched Project Innovate to assist developing businesses to navigate the regulatory requirements. The project has been called in itself a regulatory innovation by focusing on fostering new ideas through collaborative and "safe" space.[1] The project has encompassed three aspects: Innovation Hub, Advice Unit and Regulatory Sand box.[2] Each aspect focused on fostering innovation, providing advice on potential regulatory issues and creating a space in a "safe space" environment to allow companies to develop. FCA noted that it is their intention "to add more flexibility to our regulatory framework and remove barriers to entry, to encourage and support innovation where it will not erode consumer protection or the integrity of the financial system."[3] Recently, FCA has been focused on developing a Regulatory Sandbox, which is a safe space for unauthorized firms that need to become authorized before being able to test their innovation in a live environment.[4] Further the FCA has recently began engaging "regtechs" companies who use technology to assist developing companies to manage regulatory requirements. This type of direction has been taken in order to assist the UK in becoming an international leader in fintech innovation.

This approach has not been adopted by others to the same extent — other European regulatory authorities such the German Federal Financial Supervisory Authority ("BaFin") have taken a different direction and the dialogue with fintechs took a different tone.[5] BaFin indicated that while the dialogue with fintech firms is ongoing, "BaFin would continue to sharpen its supervisory focus when it comes to the issues affecting fintech companies."[6]

B. Office of the Comptroller of Currency ("OCC") – US

The US approach has been more tempered than the UK. Perhaps burnt by the financial turmoil of the last decade, the US approach to regulation has involved more concrete regulatory guidelines. In that vein, the OCC has made the first steps towards fintech regulation earlier this year. The consultation paper released by the OCC outlined their approach as "responsible innovation".[7] OCC provided their definition as follows:

> The use of new or improved financial products, services, and processes to meet the evolving needs of consumers, businesses, and communities in a manner that is consistent with sound risk management and is aligned with the bank's overall business strategy.[8]

OCC has provided what they called eight principle guidelines for the responsible innovation that include:

1. Support responsible innovation.
2. Foster an internal culture receptive to responsible innovation.
3. Leverage agency experience and expertise.

4. Encourage responsible innovation that provides fair access to financial services and fair treatment of consumers.
5. Further safe and sound operations through effective risk management.[9]
6. Encourage banks of all sizes to integrate responsible innovation into their strategic planning.
7. Promote ongoing dialogue through formal outreach.
8. Collaborate with other regulators.[10]

The summary of these principles attempts to achieve a balance between regulatory pillars like consumer protection, risk management, stability of the system and governance with market driving factors like fostering innovation, leveraging institutional expertise and customer experience. US regulators seem to be very aware of the possibility of overregulation and being left behind as an international hub, but the legacy of the earlier years remains as they attempt to put bookends around regulatory expectation and the ability of financial institutions to pursue some of these opportunities.

C. The Competition Bureau – Canada

The Canadian regulators such as OSFI and Competition Bureau ("CB") have certainly been watching the world approach for the last few years. On May 19, 2016, CB issued an announcement that they are embarking on market research in an attempt to understand fintech on the consumer and in between the lines find any risks posed by these new market entrants.[11] Interestingly enough, CB has chosen to frame its foray into fintech exploration as a market research as opposed to developing a hard line regulatory statement. It remains to be seen what approach CB or OSFI or other financial services regulators in Canada will eventually develop. However, the first steps to understanding the impact of the fintech expansion on the Canadian market has certainly began.

2. NEXT STEPS

So what happens now? As regulators grapple with the increased surge in financial technology innovation, what does this mean for the industry? The financial services industry seems to be charging on with partnerships, innovation labs and other opportunities. Each individual institution is making their own decisions based on their capabilities, strategic direction and risk management guidelines on how to forge their way forward. In the meantime, it has become apparent that the existing legislation in this area is not sufficient to address market entrants and their activities that do not fit the definition of regulated entities as set out in many home statutes. However, it is important to note that many fintech firms have begun to develop an increased level of sophistication with respect to legal and regulatory issues. One visit to a site like Mogo reveals an increase in understanding of the rules, providing disclosure and attempting to manage client expectations.[12]

As in house and external legal counsel support their clients with the new product launches, partnerships and other innovative initiatives, the major challenge and opportunity is to apply the law in a way that will protect and enable their clients. It seems that international regulatory authorities have recognized this challenge. The OCC approach is probably the more detailed attempt at defining some expectations for market participants and new entrants. It remains to be seen what approach the Canadian regulatory authorities will take, but whatever it is, such approach is very important. As consumers become active end users of various fintech technologies, the economic and protective effect of a lack in clarity could be costly. The "Wild West" of fintech can be managed through a tempered approach that will be of most assistance to most financial institutions who are dealing with these challenges daily.

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1 Financial Conduct Authority, online: https://www.the-fca.org.uk/firms/fintech-and-innovative-businesses.

2 *Ibid*.

[3] *Ibid*., online: www.the-fca.org.uk/firms/project-innovate-innovation-hub/regulatory-sandbox.

[4] *Supra*, note 2.

[5] BaFin, online: www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Pressemitteilung/2016/pm_160628_FinTechs_en.html.

[6] *Ibid*.

[7] Office of the Comptroller of Currency, online: http://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-responsible-innovation-banking-system-occ-perspective.pdf, page 5.

[8] *Ibid.,* page 5.

[9] *Ibid*., page 5.

[10] *Ibid*., page 5-6.

[11] Competition Bureau, online: http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/04086.html.

[12] Mogo, online: https://www.mogo.ca/mogo-prepaid-visa-card-fees.