



Pursuing a More Innovative Ontario Credit Union Sector: Barriers and Opportunities

Foreword

The FSRA Innovation Office was launched in 2020 to support Ontario’s financial services sector. Its mandate is to create strong, sustainable, and competitive innovations that will benefit consumers.

Since launch, the Innovation Office has developed a new, coordinated innovation vision as defined by its [Innovation Framework](#). This includes the rollout of its [Test and Learn Environments](#), which are designed to help innovators test new products, services, and business models. FSRA has also made a commitment to examine how it can use its regulatory tools to better support responsible innovation.

As part of the examination of FSRA’s regulatory tools, the Innovation Office has proactively reached out to seek input on innovative opportunities from stakeholders in the Credit Union sector. The Innovation Office has also solicited comments on what barriers they see obstructing the pursuit of innovation.

The following report provides a summary of what FSRA learned during its stakeholder outreach. This information will be used to help the Innovation Office frame the “state of play” of innovation in the Credit Union sector and to inform FSRA’s approach to supporting innovation.

FSRA would like to stress that it sees this consultation with Ontario’s Credit Union sector as an ongoing, open-door conversation. Please do not hesitate to reach out with any questions or comments you may have via your Relationship Managers from the Credit Union and Insurance Prudential unit or the [Innovation Office](#).

Executive summary

Process

FSRA's approach to innovation is guided and defined by the Innovation Framework.

There are two approaches to supporting innovation identified under the framework: the "inside-out" approach and the "outside-in" approach.

The outside-in approach involves FSRA's Innovation Office proactively reaching out to stakeholders. It seeks to identify sector trends, validate new innovation opportunities, communicate FSRA's approaches, and discuss potential ways of achieving a more innovative, prosperous Ontario financial services sector.

Stakeholders should know that FSRA's doors are always open if they have questions they would like to discuss or new products, services, and business models they would like to share and validate. FSRA will work with innovators from across its regulated sectors to support innovation, while improving and adapting regulatory responses to emerging market practices.

The inside-out approach involves FSRA's Innovation Office working with relevant FSRA teams in examining Ontario's legislative and regulatory frameworks. Its goal is to uncover and implement innovation-friendly approaches to using FSRA's regulatory tools. By leveraging the expertise and insights of teams from across the organization, FSRA will try to ensure it is using its full suite of regulatory tools and exercising regulatory discretion where appropriate.

In addition to performing inside-out research, the Innovation Office hosted a series of Credit Union stakeholder roundtables to discuss innovation, to gain an understanding of which barriers and opportunities are top of mind for the sector.

FSRA's discussions with stakeholders were fruitful, providing context regarding potential opportunities for innovation and how FSRA could play a role in making them a reality.

Takeaway messages

The most important message communicated by stakeholders during these consultations was that the *Credit Unions and Caisses Populaires Act, 2020* (CUCPA) does not specifically restrict innovation. However, stakeholders did share opinions regarding other perceived barriers to innovation in the sector and ideas on how FSRA could better support innovation.

Stakeholders raised the following three topics:

- FSRA playing a role in enabling open banking, digitalization, and payment modernization in the Credit Union sector.
- Examining the possible use and applicability of FSRA's Test and Learn Environment (TLE).
- Reviewing the existing legislative/regulatory framework and how it may impact lending structures.

The input helped shape FSRA's analysis and provides the "why" to frame the path forward.

The Innovation Office also worked with an internal FSRA team in researching key Credit Union sector innovation trends and in analyzing potential legislative or regulatory barriers to innovation in the following areas:

- Open banking, especially given the potential for fintech partnerships.
- Payment modernization and the impending changes.

In both open banking and payment modernization, cross-cutting changes were identified in the areas of data, governance, and cybersecurity.

This review concluded that while the CUCPA, its regulations, and FSRA guidance and rules do not explicitly inhibit innovation, more can be done to help clarify opportunities and further enable innovation. The main takeaway from the review was that stakeholders felt that FSRA

can help support innovation by proactively embracing emerging business models in the sector with a focus on supporting stability of the sector and protecting members.

A path forward

Open banking and payments modernization were the most salient innovation opportunities identified by our Credit Union stakeholders. This was due to the transformation that open banking and payment modernization would facilitate with regard to data portability and consumer choice.

The Government of Canada is developing an open banking framework that is anticipated to be released in 2024 and will be mandatory for federally regulated banks and optional for other financial institutions. The federal framework will establish a consumer-driven open banking framework that will regulate access to financial data. A policy statement will be released outlining the federal government's position on key policy objectives and core framework elements, including governance, scope, accreditation, common rules, and technical standards. This policy statement is intended to guide industry as the open banking framework is implemented. Provincial Credit Unions Credit Unions will have the opportunity to opt into the Open Banking Framework when it is operational.

Payments Canada is also set to upgrade existing public systems while adding a third system, "Real-Time Rail." As part of its 2023 Fall Economic Statement the federal government announced its intention to amend the *Canadian Payments Act* to expand membership eligibility in Payments Canada to payment service providers supervised by the Bank of Canada, Credit Union locals that are members of a Credit Union central, and operators of designated clearing houses. This modernization will allow for lower transaction costs and faster, more secure payments for Canadians. These developments are worth monitoring as they may impact the Credit Union sector, which access the payments system through provincial Credit Union centrals.

Another key takeaway is the potential for Credit Unions to create new lending products. FSRA's current approval process for business activities provides latitude regarding lending structures and Credit Unions are encouraged to discuss these items and issues with their FSRA relationship managers. This is also something that FSRA will keep in mind as it reviews its regulation of the sector or explores the possible use of the TLE in this area.

FSRA will ensure that it continues to develop and deepen its relationships with stakeholders in a shared pursuit of an innovative, thriving Credit Union sector. As part of this, we will continue to regularly engage with the other provincial regulators and the federal government to work on a consistent approach to regulation. FSRA will remain focused on ensuring that its stakeholders feel heard and have confidence that regulatory approaches are developed with their practical realities in mind.

What barriers to, or opportunities for, innovation do you see in Ontario's Credit Union sector? Please share your thoughts with the [Innovation Office](#).

“What we heard” – Stakeholder perspectives

Outline

The Innovation Office initiated discussions with select Credit Unions to gain external perspectives on two general topics:

- Identifying regulatory and practical barriers to innovation in the Credit Union sector.
- Identifying opportunities for FSRA to support innovation in the Credit Union sector.

In February 2023, FSRA met with a number of stakeholders, including Central 1 and FSRA's Credit Union Data Strategy and Digital Transformation Technical Advisory Committee (see Appendix for full list).

This outreach was welcomed by stakeholders from across the sector. There is strong interest from stakeholders in continuing to engage with FSRA to strengthen these relationships going forward.

Stakeholder interest and the resulting discussions focused on the following topics:

- open banking and digitalization
- payments modernization

- lending structures

Stakeholders noted that there do not appear to be explicit barriers under the CUCPA and its regulations to implementing innovative ideas. However, stakeholders felt uncertain about how FSRA would treat their innovative ideas in practice if they were to bring them to the market. FSRA is committed to accommodating innovation and encourages Credit Unions to discuss innovative ideas with their FSRA relationship managers.

Furthermore, stakeholders wanted reassurance that FSRA is working with other Canadian regulators to achieve regulatory harmonization. FSRA is a member of the Credit Union Prudential Supervisors Association (CUPSA) and, as part of this forum, regularly discusses issues aimed at promoting effective regulation and supervision of Canadian Credit Unions.

Open banking and digitalization

Our Credit Union stakeholders identified open banking as the most transformational innovation opportunity because of how it will introduce data portability and consumer choice. This is in anticipation of the federal government's open banking framework, for which proposed legislation is anticipated to be introduced in 2024.

Credit Union stakeholders noted that greater access to data flowing from open banking will enable Credit Unions to better know their customers' footprints across all their financial services. This will allow them to provide more tailored services, which will help them to better compete with the banks. Plus, by providing easier access to third-party data, it will allow them to conduct enhanced credit risk assessments.

Stakeholders generally agreed that Credit Unions are more likely to leverage third-party technology provided by fintechs than to develop their own open banking technologies. Fintechs can provide Credit Unions with specialized services to better support their customers' needs. However, they admitted that there are risks relating to privacy and cybersecurity. They also expressed uncertainty regarding accountability and liability within the system and the recourses necessary should consumer data and/or information be compromised.

Many Credit Union stakeholders expressed concern regarding having to align with potential new federal legislation and regulations for the upcoming open banking system. There was concern that there may be confusion if provincial regulators do not adopt coordinated positions with the federal government requirements. Stakeholders also flagged that any potential introduction of provincial privacy legislation could not be a barrier to open banking in Ontario.

Stakeholders encouraged FSRA to play an active role in helping to ensure that open banking is implemented seamlessly. They suggested FSRA could release guidance on how Ontario's Credit Unions can ensure they are abiding by their open banking responsibilities. Ongoing touchpoints and consultations with the sector as the federal open banking framework is implemented were also flagged as necessary to support stakeholders struggling to adjust.

The digital infrastructure capacity of small and medium-sized Ontario Credit Unions was raised as a potential barrier to their ability to prepare for and thrive in the open banking system. Ontario's Credit Unions vary considerably in terms of their technological capacity and their financial resources. This could mean that larger Credit Unions with dedicated open banking human capital and financial resources may be able to benefit from the introduction of the system, while small and medium-sized Credit Unions may be shut out. Compliance questions regarding data security and data use will require significant resources for smaller Credit Unions.

FSRA cannot solve this problem entirely, especially for Credit Unions that do not have the financial resources to invest in their open banking capacity. However, FSRA's Risk Based Supervisory Framework assessments includes operational and IT risk assessments to identify and remediate instances where Credit Union practices are not sufficient to be able to participate in open banking. Through these assessments, FSRA is also getting a picture of the sector's third-party ecosystem and associated risks to resilience and sector stability. Also, with consideration of open banking, FSRA has recently issued its Operational Risk and Resilience Guidance, and the IT Risk Management Guidance and has operationalized the enhanced data collection initiative to help raise data capability and governance standards sector-wide. These measures will help Credit Unions focus their resources on meeting the necessary standards rather than trying to interpret their regulatory responsibilities under the new system.

When open banking is implemented, FSRA will develop an approach to designing, preparing, and implementing requirements for CUs, leveraging the existing prudential framework while meeting sufficient characteristics of the proposed accreditation requirements expected from

other participants. Moving forward, FSRA will also continue to engage sector stakeholders to better understand and respond to their concerns as the open banking system continues to be developed.

Payments modernization

Stakeholders noted the ongoing payments modernization process as an important driver of innovation that could impact Credit Unions. This modernization process will see Canadian payments transition from a national systemic architecture to a modular architecture that can be used in diverse ways.

Payments Canada, an organization overseen by the federal Department of Finance, currently operates two public systems:

- **Lynx**, which replaced the Large Value Transfer System in September 2021, is the electronic wire system used for clearing and settling large-value, time-critical Canadian dollar transactions between Canadian financial institutions.
- **The retail batch payment system**, which has two components:
 - **Automated Clearing Settlement System (ACSS)**, which clears and settles Canadian dollar cheques and electronic payment items (direct deposits, ATM withdrawals, point-of-sale transactions, online payments, and pre-authorized debit and bill payments), while tracking the exchange of payments and resulting balances of direct participants.
 - **U.S. Dollar Bulk Exchange (USBE)**, a parallel system to the ACSS but specialized for electronic payments in US dollars in Canada.

The payments modernization process involves upgrading these two public systems while adding a third system:

- **Real-Time Rail**, which will bring Canada up to speed with more than 50 countries currently deploying similar systems and meet the needs that the current privately held Interac e-transfer service cannot. It will:
 - a) Leverage the ISO 20022 messaging standard.
 - b) Have a five-second threshold.
 - c) Settle on the back end in seconds, rather than hours or days.

Stakeholders view these modernization efforts as allowing for faster payments and higher-quality, more consistent accompanying data. Moving money and settling transactions quickly is more convenient and secure for all good-faith parties and reduces the risk of payment delays and fraudulent transactions. Payments moving with enhanced data standards also allows companies to port payments directly into their account software rather than having to reconcile it manually or semi-manually. This could have useful tax system implications.

Improving and standardizing both the quality and quantity of data travelling with payments is a crucial driver of innovation. The more quality data generated per payment, the more “fuel” will be available to develop innovative use cases.

Stakeholders have flagged that some consumer risks could result from the implementation of payments modernization. Their primary concern is that Real-Time Rail payment liability rests with the sender, which could be problematic in cases of fraud. To respond to this, Payments Canada is setting out provisions that allow financial institutions to do extra checks for certain transactions. However, Payments Canada’s general approach is non-prescriptive and based on its view that financial institutions must have their own fraud provisions.

For context, due to considerations such as cost and scale, there are not many direct payment clearers in Canada. Thus, at this time, Credit Unions will not be eligible to become direct clearers accessing real-time rail, and will continue clearing through the provincial Credit Union centrals. However, there was general interest in payment modernization developments and the impact it may have and ways it could benefit members. With this in mind, stakeholders could not identify any FSRA-related regulatory or practical barriers to Credit Unions adapting to ongoing payments modernization but want assurance that FSRA is keeping up to date on

developments in the payment space. To this end, FSRA will continue to monitor and engage with Payments Canada to provide FSRA's perspective on the ongoing payments modernization project.

Lending structures

Stakeholders flagged that there could be potential for Credit Unions to create new lending products, such as rent-to-own loans and other novel approaches.

Stakeholders stressed that social inclusion is at the core of the Credit Union model. As community-focused financial institutions, Credit Unions are well-placed to drive greater inclusion, improve access to necessary loans for a wider range of Ontarians, and help address issues like housing affordability.

Stakeholders noted that new lending structures may require FSRA to revisit some of its prudential requirements, including its Capital Adequacy Requirements Rule. Supporting innovation in this area will require FSRA to strike a balance between maintaining prudent regulation and supervision of Credit Unions, while enabling flexibility for them to drive social inclusion. It should be noted that FSRA does have discretion to allow for novel structures within the current framework, including products similar to "rent to own," and the ability to specify risk-weightings for new types of investments for capital purposes, and encourages Credit Unions to reach out to their FSRA relationship managers with proposals as a first point of contact.

Stakeholders highlighted the potential for FSRA's TLEs to be leveraged to explore new, otherwise prohibited lending structures that focus on driving social inclusion of underserved demographic groups or communities. In response, FSRA signalled to stakeholders that while TLEs are meant to test new products and services, they can also be used to explore potential policy changes and new regulatory approaches, within the limits of FSRA's exemptive authority and discretion.

The use of TLEs in this manner is a possible avenue for FSRA to allow Credit Unions the regulatory flexibility they need to innovate. Stakeholders also encouraged FSRA to keep community benefit and social inclusion in mind when FSRA next reviews its Capital Adequacy Rule.

Conclusion

This Opportunities Report provides a summary of what FSRA has heard from stakeholders about possible barriers and opportunities for innovation in the Credit Union sector. The regulator continues to work internally on researching the views and ideas expressed during these consultations to inform where and how FSRA can continue to support innovation in the Credit Union sector.

In keeping with the outside-in approach to supporting innovation, FSRA remains committed to open dialogue with the Credit Union sector. The enthusiasm with which stakeholders shared their ideas when called upon has not gone unnoticed. FSRA looks forward to continuing these discussions and encourages stakeholders to reach out to the [Innovation Office](#) or their relationship managers with their innovation-related comments and questions.

Through continued engagement with the sector, FSRA's Innovation Office, the Supervision team and Relationship Managers are interested in hearing your perspectives on the following questions:

- What innovations and trends are you seeing in the Credit Union sector that could benefit consumers or improve business efficiency for industry players?
- How are these innovations and trends intended to benefit consumers?
- What if any consumer risks do you foresee from the implementation of these innovations and trends?
- Is Ontario's regulatory environment currently conducive to the adoption of these innovations or trends? If not, what barriers do you see?
- Would your firm have interest in participating in a FSRA Test and Learn Environment to pursue an innovation opportunity? If so, what sort of opportunity would you want to pursue?

Appendix: Round table participants

The following organizations participated in series of round tables in February 2023 to give input for the Credit Union innovation opportunities report:

- Central1
- Copperfin Credit Union
- Canadian Credit Union Association
- Libro Credit Union
- Alterna Savings Credit Union
- Northern Credit Union
- DUCA Credit Union
- Desjardins Ontario Credit Union
- Meridian Credit Union
- Main Street Credit Union
- Northern Birch Credit Union