Canada's financial sector: an industry in transformation

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The Canadian financial sector has proven its strength over the years, including, notably, in response to the 2008 financial crisis.

With a track record of resilience, it is no surprise that both the Canadian Government and financial services industry acted swiftly in the early stages of the COVID-19 pandemic and collaborated closely to ensure a smooth and cohesive response to the economic fallout of the crisis in Canada. In this article, we explore the financial sector's digital transformation, and trends that will shape the industry in the months and years ahead.

Accelerated move to digitization

Canadian financial institutions pivoted quickly to support their clients, implementing payment deferral programs and other temporary relief measures for their customers (with the cooperation of the Office of the Superintendent of Financial Institutions), and building systems to connect customers with federal relief programs using automation instead of advisers. At the same time, Canadian financial institutions are working closely with the Government to ensure that consumers and businesses receive the right level of support over the course of the pandemic, essentially providing these services "at cost" (this stands in contrast to banks in the U.S. who have been generating processing fees from the U.S. government of up to 5 per cent to administer small business relief loans).

Canadian banks were already on the path towards digitization, automation and virtualization of their services with the goal of reducing costs, but these efforts have accelerated significantly as a result of the COVID-19 crisis, with the industry experiencing a surge in the use of its technology and digital channels by customers since the onset of the pandemic.

The pandemic has also seen a surge in cashless transactions, which will only further contribute to the digitization of banking.

Bloomberg News recently observed that while Canada's largest banks have spent more than $100 billion on technology since the 2008 financial crisis, they are only now finally seeing record shifts into digital banking after years of urging customers to try their latest innovations[1]. For example, significantly more mortgage renewals are being handled online, electronic deposits are increasingly used to disburse government benefits, and some older customers —who may have previously been reluctant to utilize online banking tools—have started to embrace online banking. While customer engagement in digital banking continues to gain ground, it is accompanied by a rising risk of privacy breaches and cyber attacks, which we discuss here.

Given the ongoing push for digital transformation in the industry, we expect that many banks may revisit their distribution channels and branch networks in the fallout of COVID-19. In last six months, several banks have also accelerated the roll-out of processes to allow for remote client instructions via telephone calls, as well as e-signature functionality, while others have introduced online tools to better serve customers, such as video-conferencing capabilities.

The pandemic has also seen a surge in cashless transactions[2], which will only further contribute to the digitization of banking. As financial institutions push to accelerate their technology offerings for customers, they are also exploring how technology and process innovation can increase efficiencies internally, including with respect to the management of commercial contracts in their in-house legal departments (discussed here).

While it is still too early to predict the lasting impact of COVID-19 on the financial services industry and the behaviours of its customers, it appears that a permanent shift to full-scale digitalization may soon be upon us.

Changing payments landscape

Major changes to Canada's payments landscape are set to take place in the coming years. Alternative digital payment solution platforms have entered and expanded the market. Meanwhile, niche offerings, ranging from independent online trading platforms to digital loans and new financing providers, are surfacing. As industry players collaborate to identify standards that may need to be developed as the industry undergoes digital transformation, they will need to consider mounting competition risks, discussed here.

Meanwhile, Payments Canada is undertaking a multi-year initiative to modernize the nation's payments ecosystem, giving way to growing opportunities for Canada's payment service providers—read here to learn how it might be a good time for industry players to re-think their overall business strategies.

Growing litigation risks and enforcement action

More attention is being paid by class action counsel and regulators to the relationship between financial institutions and their clients, especially with regard to the duties owed by financial institutions. Sources of potential litigation include consumer protection matters, with potential risk areas covering adequate and clear disclosure of fees, conflicts of interest, and exclusions of liability for specific events in standard consumer contracts.

Meanwhile, the role of The Financial Consumer Agency of Canada (FCAC) is expanding, and we anticipate that the regulator's enhanced sanctioning powers under the new consumer protection regulatory framework (click here for details) will give way to heightened enforcement action (read more here).

At the same time Canada's anti-money laundering regulator, the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC), is resuming desk examinations of industry players' potential breaches of anti-money laundering and countering terrorist financing legislation. This will further lead to heightened regulatory scrutiny in the financial services industry.

A focus on insurers

Equally in the insurance space, market conduct oversight of insurers and intermediaries is intensifying, with growing focus by insurance regulators across Canada on the fair treatment of customers (read more about this development here).

Customers have, unsurprisingly, been contacting their insurers more frequently, leveraging online platforms with in-person communication remaining largely unavailable. Many insurers have taken the proactive step of circulating mass outbound email communications to their customers in order to preserve the phone/call centres for more urgent claims, which in many cases have led to an increase in customer experience and personalization that might have been lacking as compared to other financial services (such as retail banking). In addition, there is an opportunity for insurers to innovate in their product lines, such as products that would be payable in the case of a pandemic.

Dealmaking opportunities

Although strong M&A activity in the financial services sector levelled off with the onset of the COVID-19 crisis, we expect the current complexities facing industry players—including margin compression, expense pressures, IFRS 9 angst, capital sensitivities, implementation of IFRS 17, and volatile performance of AUM, to name a few—to present ongoing M&A opportunities for investors. A number of Canadian banks have also recently issued "limited recourse capital notes", or LRCNs, in public offerings to institutional investors, as they take steps to enlarge their additional tier 1 regulatory capital.

In the meantime, industry practices are evolving to address the emerging risks posed by unmanaged conflicts of interest for the investment banks advising on M&A transactions. Financial advisors can be attacked in a number of ways in the context of a contested M&A deal, and practices are developing to mitigate those risks (see here).

Conclusion

Despite the host of challenges facing financial institutions—particularly in this new environment of uncertainty—the industry in Canada has demonstrated its agility and ability to innovate and source opportunity under pressure. While it remains to be seen how the financial services sector will navigate the road ahead, its history of resilience gives us good reason to be optimistic.

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[1] https://www.bnnbloomberg.ca/pandemic-accelerates-canada-s-shift-to-electronic-banking-1.1425396

[2] According to Payments Canada, 62% of Canadians reported using less cash since the onset of the pandemic, while 42% of Canadians surveyed reported that they avoided shopping in places that did not accept contactless payments. Available here.