Intelligence MEMOS

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To: Financial System Policymakers

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Re: **Tariff Response Needs to Include Fast Financial System Modernization**

Donald Trump's tariff threats have underscored the need for Canada to diversify its international trade and reduce interprovincial barriers. If our financial system is to be effective in helping bring about these changes, its regulatory underpinning needs modernization. Canada's customary glacial pace will not cut it. We need to act now.

Start with payments. Trading more with other countries requires a safe and efficient cross-border payment system that allows exporters and importers to transfer funds cheaply and quickly with little risk of payments going astray or taking days or even weeks to settle. As anyone who has ever sent or received money across borders knows, such transfers leave much to be desired. Both the sending and receiving bank can require fees. Payments, though they're electronic, can take lots of time to land, depending on the countries and number of banks involved. And they may not be recoverable if there are errors in the sender's instructions. Canadian officials need to work with their international counterparts to enable payments to be made safely, cheaply, and in real time, i.e., instantly.

That will also require modernizing our own practices. Canada is the only G20 country without a payments system that enables consumers and businesses to make and receive payments around-the-clock with funds available in real time. Though personal bank account balances are often updated when a payment is made, the actual transactions usually only settle the next business day – even later if a paper cheque is involved. By contrast, in some European countries, transactions settle instantly and the funds are immediately available.

Modernizing also means looking ahead. The people who use and run the payment system should think hard about newer technologies, like blockchains and stablecoins linked to conventional currencies, which might be safer, faster, and cheaper than today's systems.

Canada's financial sector has been far too slow to adopt new technologies. Open banking, for example, would give Canadians more control over when and how to share their financial data, which could help spur development of tailored products and services that would create a more innovative and competitive market for financial services. Open banking has arrived in the UK, the EU, Australia, and (though it's fragmented) the US. It's getting closer in Canada, but after years of work, it still isn't off the ground.

This is also a good time for broader reform. Removing redundant regulations is an easy but important first step. The Office of the Superintendent of Financial Institutions is currently removing duplicate guidelines and advisories for banks and other institutions under its purview. Getting rid of stand-alone regulation whose costs outweigh its benefits is trickier, but potentially just as important. Analysis across the different financial subsectors – banking, insurance, and wealth management – suggests Canadian regulators have tended to focus on consumer protection and stability rather than competition and efficiency, but without sufficient cost-benefit analysis to justify that tilt. There may therefore be ways to make the system more dynamic without sacrificing safety.

Instead of hyper-cautious rules that slow everything, we need better processes to manage failures so that an institution that has been hit and cannot recover on its own can be safely separated from the system without sending the whole economy into cardiac arrest. If the Canada Deposit Insurance Corporation could speed up claim payments when a failing institution cannot be merged with a healthier one, that would help. And so would more attention from financial regulators to resolution issues in their oversight. The more we can contain any collateral damage, the more we can tolerate failure, which could lead to a simpler regulatory framework that is more amenable to both new entrants and exits from our financial system.

We should also consider ways to enable institutional investors like pension funds and life insurance companies to invest more in the new infrastructure Canada may need in order to diversify trade. Current rules for life insurers essentially treat all debt instruments not rated by credit rating agencies as below investment grade. But the debt of many infrastructure projects, like new pipelines, is likely to be an investment grade in practice. Life insurers should be able to use their own models – subject to regulatory approval – to measure and manage the risks of such investments, as the major banks and pension funds are allowed to do.

It supposedly was Lenin who said "there are decades when nothing happens, and weeks where decades happen." For better or worse, we appear to be in one of those narrow windows of change. To help Canadians adjust to the big changes looming in our trading relationships, we need to reform our financial regulation. Now is a good time to start.

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