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The Banking/Commercial Separation Doctrine in Comparative Perspective

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Cristie Ford

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Introduction

Banks have long provided essential services to the economy and to Canadians. In return, they have had access to special privileges, and been subject to special prohibitions. Across the world, there are boundaries around what we in Canada would call the "business of banking". Such boundaries are important, because they set the conditions under which institutions may be recognized as "banks," and may have access to those privileges and prohibitions. This report summarizes research undertaken across five jurisdictions – Australia, Japan, Singapore, the United Kingdom (UK), and the United States (US, federal level only) – with respect to a particular kind of boundary on the business of banking: the separation of banking business from commercial business. "Commercial" here means the provision of *non-financial* goods and services. This separation exists under what in the United States has long been referred to as the "banking/commercial separation doctrine".

The banking/commercial separation doctrine operates against a backdrop of other boundaries, notably including bank licensing regimes.[1] Only institutions with banking licenses or equivalent state permission may carry out the core businesses of banking at all; i.e., only they may take deposits or other repayable funds from the public, which are payable on demand, and readily transferable to third parties on the depositor's instruction.[2] The fact that banks take deposits and provide transaction accounts, thereby providing individuals and the economy with a liquid, mobile, accepted medium for the movement of capital, is what historically has distinguished them from other financial institutions, and has made them so important to the economy. Deposit-taking in particular is sometimes identified as the core characteristic of banking.[3]

Against this backdrop, the business of banking has changed radically over the past 30 years. Because of technology, in many jurisdictions, some of the core banking functions that made banks "special," and that made them central to proper functioning of the economy and the capital markets, can now be provided by non-bank entities as well, through new products and new services. Banks' own services and products are also evolving. Importantly, even where the banking/commercial separation doctrine is in place, banks are already able to engage in a fairly wide range of financial (as opposed to non-financial, commercial) business. Existing regulatory provisions allow for "ancillary" business lines, or business lines that are "closely related" to banking. The step from banks' existing practices to entering into genuinely commercial, non-

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[1] I use the generic term "license" to refer to the concept of a license that banks must obtain in order to operate as banks. In practice, the terminology varies; for example, in the United States, banks receive "charters" rather than "licenses." The word "bank" is also used generically here, to refer to institutions by whatever name (e.g., "credit institutions," in the EU) that may carry out the core banking businesses: taking deposits or other repayable funds from the public, and issuing loans.

[2] The language of "taking deposits or other repayable funds from the public" is drawn from Directive 2013/36/EU, at Article 9, though similar language exists elsewhere. Note that payment systems, such as PayPal or Apple Pay, are not in fact engaging in this activity and are not "banks." EC, Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, [2013] OJ, L 176/338.

[3] See E. Gerald Corrigan, "Annual Report 1982: Are Banks Special?" (1 January 1983), online: Federal Reserve Bank of Minneapolis <https://www.minneapolisfed.org/publications/annual-reports/ar/annual-report-1982-complete-text> at para 8. For more on the theoretical foundations of banking, including the maturity and liquidity mismatches that characterize the banking business, see, e.g., John Armour et al, *Principles of Financial Regulation* (Oxford: Oxford University Press, 2016) at 275-89.

financial work is meaningful, but it is an extension of existing business rather than something of an entirely different order.

Regulation has been evolving in response to change in the industry, as well as in response to lessons learned in the recent financial crisis about banks' exposure to broader market risks (including risks being run within their own corporate groups), and about the nature and sources of systemic fragility and risk. Prudential regulation to safeguard against systemic risk, in particular, has become a powerful tool. Relative to those sophisticated tools and in light of contemporary technology (for communications, for effecting financial transactions, and for deploying data), the traditional banking/separation doctrine now seems like a somewhat arbitrary, anachronistic, and blunt tool.

Three of the five jurisdictions reviewed here, notably the United States (US) and, following it, Japan and Singapore, have a specific provision embedded within their licensing regimes that would prohibit banks, as defined above, from engaging in commercial, that is non-financial, business. The banking/commercial separation doctrine is not part of the regulatory regimes in the United Kingdom (UK) or Australia, where financial regulation is based on a "twin peaks" model. Of the three jurisdictions that do impose a banking/commercial separation doctrine, none has eliminated it entirely. However, the distinction is being relaxed in Japan and Singapore. In the US, the doctrine is arguably at risk of being circumvented altogether by new fintech companies, in part because other (state-level) regulatory licensing options, which do not apply the separation doctrine, exist.

Yet the concerns that produced the banking/commercial separation doctrine are as real as ever. It remains important to protect against risks that flow from the business of banking: notably mitigating systemic risk, protecting state deposit insurers from over-commitment, and maintaining a functioning market for financial services (by ensuring fair competition, eliminating potential conflicts of interest, and addressing market concentration concerns). Based on a review of the jurisdictions studied here, however, it may be that these concerns can be better met through other regulatory requirements than through the banking/commercial distinction. The prospect of banks engaging in commercial work may no longer be the most important concern. The concerns that such activity raises can be addressed better by focusing explicitly on the regulatory concerns themselves – mitigating systemic risk and protecting consumers – rather than attempting to regulate through the imperfect proxy of the banking/commercial separation doctrine.

In the UK, in spite of the lack of an explicit banking/commercial separation doctrine, banks apparently nevertheless refrain from engaging in non-financial commercial activity. The primary mechanism that has limited that engagement has been prudential regulation. Reportedly, UK banks to date have interpreted the prudential regulatory requirements that apply to them to conclude that engaging in non-financial commercial business lines would not be profitable. (Ring-fencing may change this but it also changes the scope of the "special" part of the banking business, as discussed below.) Note, however, that banks in Australia seem to have interpreted very similar regulatory provisions in a way that allows them to branch out into such business lines. Australian regulatory standards have not provided guidance or clarity on the appropriateness of this interpretation, and they have not responded in a fashion that would force banks to be transparent about the risks they are running in such business lines. *Prudential regulation on its own will not work to limit the risks associated with banks engaging in commercial business, unless banks are required to be explicit and transparent about how they*

assess risk, and unless they are required to disclose and manage risks associated specifically with their non-financial commercial businesses as well as their banking and financial ones.

This report and its appendices identify the following practices, adopted in some of the jurisdictions studied here, as relevant:

- The banking/commercial separation doctrine exists in the US, Japan, and Singapore. In each of these jurisdictions, however, it is no longer an entirely "bright line" rule. For example, the definition of the "business of banking" in each of these jurisdictions has evolved to include a range of ancillary businesses, including both financial and (most explicitly in Singapore) certain permissible non-financial ones. Banks in these jurisdictions have also traditionally been prohibited from owning substantial investments in non-financial companies, but these limits are also being relaxed in both Japan and Singapore.
- In the US, developments are somewhat distinct: because of its "dual" federal/state bank licensing regime, fintechs and other startups are able to do business, sometimes in cooperation with a state-licensed bank, without having to seek regulatory approval from the main federal regulator, the Comptroller of the Currency (OCC), and therefore without being subject to the banking/commercial separation doctrine at all. Regulatory competition has also caused the OCC to develop a controversial new "restricted" federal bank charter. A principled policy discussion about the continued need for the banking/commercial separation doctrine has not emerged in the US.
- In the UK, where there is no banking/commercial separation doctrine but following Basel II and III and EU Law, prudential regulation that applies *across a bank's subsidiaries* has been an important practical tool for managing systemic risk in the financial system. Techniques for assessing and managing an institution's safety and soundness have developed significantly since the turn of the millennium. These days, when banking activities (and deposit-like and loan-like products) extend across financial regulatory sectors, sometimes producing massive systemic risk, it is not obvious why a bank's potential commercial/retailing activities in particular should be singled out for opprobrium. At the same time, absent extenuating circumstances, all of a bank's activities should be presumed to affect the bank's safety and soundness, and the bank as a whole should be presumed to be benefiting from the special privileges that flow from licensing.
- In addition, the United Kingdom has recently implemented regulatory "ring-fencing" of banks' traditional consumer depository banking functions, to ensure that a bank's commercial activities do not generate systemic risk, or undue pressure on state deposit insurance. Under ring-fencing, any commercial businesses that a bank might choose to run would almost certainly fall outside the "fence," meaning outside the zone of special privileges and prudential regulation.
- In Australia, the large banks now engage in a range of non-financial commercial activity, which they consider they are not required to disclose under existing prudential standards. New prudential standards, set to come into effect in January 2020, are somewhat more comprehensive in transparency terms but still fall substantially short of what is recommended here. The new proposed standards, like the existing ones, still operate on a vision of a bank as a fundamentally financial institution. The changing nature of the

banking business, in Australia and internationally, suggests that this limited vision will not capture the full range of businesses in which banks are engaging, in the near future.

- Banks in general have access to enormous, high-quality data about their customers. Given the central importance of data to modern business models (financial and non-financial), this data is extremely valuable. Particularly in jurisdictions where the banking industry is already highly concentrated, allowing banks to extend into commercial businesses with the benefit of that data could produce concerns about competition. The objectives of ensuring competition, avoiding excessive market concentration, and minimizing the kinds of conflicts of interest that can choke off commercial competitors' access to necessary funding have been addressed through Open Banking initiatives in several jurisdictions, including the UK, Australia, and soon Japan. Several jurisdictions – the US OCC, Australia, and the UK – have also taken steps to make it easier for fintechs to obtain either restricted, or full, banking licenses.
- Just as important are some comparator jurisdictions' efforts to protect customers' rights, their data, and their privacy. For example, prohibiting anyone from selling customers' data without the consumers' consent, as Australia has begun to implement, would be a useful response that could apply comprehensively to any organization or individual. On a more limited scale, a customer data right that applied to financial institutions would address some customer protection and human dignity risks in this one sector.

This report does not cover a number of potentially important developments around banking, "fintech", and regulation, including:

- payment systems, wholesale and retail, including e-commerce and cross-border remittances;
- the traditional division between banking, investment and securities, and insurance;
- "fintech" initiatives within the boundaries of financial businesses, including e.g., robo-advising, e-trading, P2P lending (in the securities/investment banking space); insurtech; money in various forms including e-money and digital assets, and any initiatives relating to cryptocurrencies or distributed ledger technology;
- state-level initiatives in the US; and,
- the EU, except to the extent that EU Directives have been incorporated into UK domestic law. Note, however, that the EU has been at the forefront of the Open Banking and consumer data protection fields through the Revised Payment Services Directive.[4]

The report begins by discussing bank licensing, which is an important background condition and which is distinct from the banking/commercial separation doctrine.

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[4] "Payment Services Directive 2 (PSD2)" (1 December 2017), online pdf: *Temenos* https://www.temenos.com/globalassets/mi/wp/16/temenos psd2 whitepaper v2.pdf.

Banking as "special"

Banking licenses and the "business of banking"

Banking is not like "regular" commercial business, or indeed quite like even the securities or the insurance businesses (being the other two broad categories of business under the traditional entity-based financial regulatory approach). Because of the central role that banks have traditionally played in the economy in offering transaction accounts for individuals and businesses, being the backup source of liquidity to all other institutions, and serving as a transmission belt for monetary policy, banks have long been considered to be "special."[5]

Banks have traditionally given individuals and businesses access to the payments system, and provided and created a liquid medium of exchange and savings for normal peoples' "real economy" needs. The fact that they have performed these essential functions, in turn, has meant that banks have had access to extraordinary privileges, and have had additional regulatory obligations, relative to normal commercial enterprises. To support banks' functioning, to avoid harmful bank runs, and to maintain stability in the banking sector, most modern economies have instituted deposit insurance.[6] Banks facing liquidity problems also have access to short-term lending from their countries' central banks or equivalent.[7] In times of real crisis, banks may also have access to additional discretionary lender-of-last-resort (LOLR) funding and even bailouts, offered either through the open market or to specific banks. For all these reasons, banks can avoid consequences of illiquidity that normal commercial vendors cannot.

In return, all the jurisdictions examined here have imposed some boundaries around the business of banking, specifically by instituting licensing regimes under which only sanctioned and recognized "banks" may engage in the core business of banking. Entity-based and "twin peaks" regulatory structures, discussed further below, differ in terms of how they slice up the regulatory task. However, they are the same in maintaining licensing regimes for banks, in view of the particular position that banks hold in the economy, in society, and within overarching economic

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[5] This list of characteristics and the language of "specialness" comes from a famous speech by E. Gerald Corrigan, who at the time was President of the Federal Reserve Bank of Minneapolis, *supra* note 3. The discussion of bank "specialness" here is based on a traditional understanding of what functions banks provide within the economy – an approach that makes sense in the context of evaluating the traditional banking/commercial separation doctrine. The report should not be understood to be saying that traditional banking still functions precisely as it did in the middle of the twentieth century, for example (when the American *Banking Holding Company Act* was passed). On the contrary, banking and financial services generally have been transformed through technological and business process change. One of the most important recent analyses of the modern financial system, which directly challenges the notion that only banks should have access to deposit insurance, is Morgan Ricks, *The Money Problem: Rethinking Financial Regulation* (Chicago: University of Chicago Press, 2016). If accepted, Ricks's argument likely only strengthens the case for saying that the traditional banking/commercial separation doctrine should no longer be a central pillar around which banking regulation is built.

[6] In the jurisdictions discussed here, they are as follows: in Australia, the Financial Claims Scheme (FCS); in Japan, the Deposit Insurance Corporation of Japan; in Singapore, the Singapore Deposit Insurance Corporation (SDIC); in the United Kingdom, the Financial Services Compensation Scheme (FSCS); in the United States, the Federal Deposit Insurance Corporation (FDIC). Canada's equivalent is the Canadian Deposit Insurance Corporation (CDIC).

[7] Lender-of-last-resort (LOLR) functions can take different forms, of which the most familiar is the so-called "discount window." In the jurisdictions discussed here, LOLRs are as follows: in Australia, the Reserve Bank of Australia; in Japan, the Bank of Japan; in Singapore, the Monetary Authority of Singapore (MAS); in the United Kingdom, the Bank of England (which uses the term "liquidity insurance" rather than LOLR); in the United States, the Federal Reserve system. Canada's equivalent is the Bank of Canada.

and fiscal architecture. A set of regulatory obligations and privileges, attendant on being a licensed bank, flow from the licensing.

Banking licensing requirements incorporate two main elements:

- a definition of "the business of banking," the core of which comes down to the deposit-taking function though depending on the regulatory structure it may include other things, including especially lending – the other side of a commercial bank's traditional business model; and,
- a requirement that anyone engaged in the business of banking must be *licensed.* The terms vary; e.g., in the United States, banks obtain "charters" and in the European Union, "credit institutions" receive what we would recognize as banking licenses. In a fragmented regime like the American one, several separate licensing applications (to, e.g., the OCC, the Federal Reserve system (the Fed), and the Federal Depository Insurance Corporation (FDIC)) – not to mention alternative state regulators – may be required. However, the basic existence of a licensing regime is common across jurisdictions.

The relevant statutory provisions and licensing regimes are identified in Appendix 1.

Licensing continues to be an essential mechanism for controlling access to the banking business. Yet, entry requirements have relaxed somewhat in some jurisdictions, reflecting the changes that technology and innovation have wrought.[8] These are also described in Appendix 1, and Appendix 3. While not directly affecting the banking/commercial separation doctrine, the loosening of licensing requirements is relevant in that it, like the relaxation of the banking/commercial separation doctrine itself, reflects a general regulatory move away from heavy reliance on "bright-line" standards, toward a regime that is more sensitive to context and business realities, and that has access to more targeted and accurate strategies for achieving regulatory objectives. Licensing on its own is necessary, but not sufficient. With licensing in place and where other, meaningful safeguards and more appropriate regulatory mechanisms exist, the banking/commercial separation doctrine may in fact no longer be necessary.

The banking/commercial separation doctrine in the United States

For over a century, in addition to licensing provisions, American federal banking law[9] has also generally prohibited banks from engaging in commercial activity. The reasons are important

[8] In the words of the United States Office of the Comptroller of the Currency in a press release, for example, a new restricted bank charter for fintech companies, launched by the OCC, "helps provide more choices to consumers and businesses, and creates greater opportunity for companies that want to provide banking services in America," and "is consistent with bi-partisan government efforts at federal and state levels to promote economic opportunity and support innovation that can improve financial services to consumers, businesses, and communities." US, Office of the Comptroller of the Currency, News Release, 2018-74 "OCC Begins Accepting National Bank Charter Applications from Financial Technology Companies", (31 July 2018), online: https://www.occ.gov/news-issuances/news-releases/2018/nr-occ-2018-74.html.

[9] This report covers only the federal level within the American banking regulatory system. There, the OCC is the chartering authority, supervisor, and regulator of national banks. The FDIC has supervision of all banks, both federal and state, in relation to deposit insurance. Functionally, this makes the FDIC a concurrent regulator of national banks and the primary federal-level body with oversight over state-chartered banks. (Some states, notably Utah, have a quasi-bank option, the Industrial Loan Company (ILC), whose deposits are FDIC insured but which are not

ones, which go to the same concerns about the importance of banks to the economy, and the particular privileges and prohibitions they have as a result, which spurred the development of banking licensing regimes as a whole. To be clear, the banking/commercial separation doctrine is *not* the distinction between banking, securities, and insurance work. It is also not about the separate question of whether commercial entities should be permitted to own banks.[10] For purposes of this report, the banking/commercial separation doctrine concerns the prohibition on banks engaging in *entirely non-financial* commercial businesses.

As already noted, being a licensed and recognized "bank" confers some important advantages on an institution. In particular, because of their access to deposit insurance, banks are able to borrow money at reduced rates. Depository insurance, along with banks' access to liquidity support from their jurisdictions' central bank or equivalent, effectively subsidizes them relative to other businesses.[11] Banks can avoid consequences of illiquidity that normal commercial vendors cannot. Flowing from this, the historic rationales for separating banking and commerce, as articulated primarily in the United States, have two main threads:[12]

- Systemic risk and banks' unique privileges: Safety and soundness and systemic stability concerns, in various forms through time, have informed the American banking/commercial separation doctrine. Bank runs, and bank crises, can have knock-on and contagion effects that worsen a crisis almost independent of the size of the underlying problem. Access to the banking "safety net" addresses contagion concerns. However, these safeguards also mean that banks are insulated from some normal business risks, and can borrow money more cheaply as a result. It has been perceived as unfair and anticompetitive to allow these special players to compete with regular commercial businesses. Moreover, bank regulators would have difficulty extending their regulatory

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subject to other federal bank regulation and, among other things, are not subject to the banking/commercial separation doctrine.) The Federal Reserve Board also has oversight over those state-level chartered banks, a minority, which are members of the federal reserve system. In addition, it has jurisdiction over bank holding companies – the parent corporations of banks, to whom a separate set of regulatory provisions apply. Since the financial crisis and the creation of the Financial Stability Oversight Council (FSOC), the Fed has acquired additional oversight powers in relation to "SIFIs" (systemically important financial institutions, including non-bank ones). SIFIs and financial holding companies (FHCs), which can engage in a broader range of financial activities including e.g., insurance and underwriting, are also not covered here. Vis-à-vis "fintech" companies in particular, the OCC and state regulators have been vying for position. The OCC's restricted charter, discussed below and in Appendix 1, was heavily criticized by state regulators (in fact, it was the subject of two lawsuits, which were vacated), who consider that states should be have regulatory jurisdiction over fintech companies that are not engaged in the traditional banking business.

[10] Mehrsa Baradaran has argued that these two questions – whether banks should be permitted to engage in commercial activity, and whether commercial entities should be permitted to own banks – are often conflated in policy discussions and scholarly articles. She argues, in fact, that allowing commercial entities to own banks would improve systemic stability, reduce contagion and herding effects, reduce the asset-liability mismatch from which banks suffer, and incentivize banks to take on less risk and better control their leverage ratios: *see* Mehrsa Baradaran, "Reconsidering the Separation of Banking and Commerce" (2012) 80:2 Geo Wash L Rev 385.

[11] Anat Admati & Martin Hellwig, *The Bankers' New Clothes* (Princeton: Princeton University Press, 2013).

[12] These points are drawn primarily from Arthur E. Wilmarth, Jr., "Wal-Mart and the Separation of Banking and Commerce" (2007) 39:4 Conn L Rev 1539; *see also* Edward L. Symons, Jr., "The 'Business of Banking' in Historical Perspective" (1983) 51:5 Geo Wash L Rev 676; Bernard Shull, "The Separation of Banking and Commerce in the United States: An Examination of Principal Issues" (1999) OCC Economics Working Paper 1999-1. As Shull has noted, *ibid.* at p. 7 et seq., the prohibition on banks engaging in commerce distinction has its roots far earlier, going back to banking in 14th century Italian city states.

reach to other commercial parts of the corporate group, even though those parts' economic viability could affect the connected bank's safety and soundness.

- Additional consumer protection and competition concerns, which we can further break down into concerns about (a) conflicts of interest and (b) market power/concentration. Flowing their superior borrowing abilities as described above, there has also historically been a concern in the United States that banks would be able to subsidize any non-bank commercial business they engaged in, thereby providing those commercial businesses with an unfair market advantage. Because they operate subject to a conflict of interest, banks engaging in commerce could also potentially refuse to provide loans to competitors of their commercial affiliates, or could require borrowers to do business with their commercial affiliates as a condition of obtaining loans. Banks that engage in large-scale commercial activity (e.g., Bank of America's parent company Transamerica in the 1950s, whose expansion plans led to the passage of the *Bank Holding Company Act*; department store Montgomery Ward in the 1970s, or Wal-Mart in the early 2000s) may also acquire undue market power, allowing them to concentrate the market in anticompetitive ways.[13]

In jurisdictions where the banking industry is concentrated and forms a large part of a national economy, and where it relies heavily on customer deposits (as the Financial Stability Board (FSB) has noted is the case in Canada),[14] systemic stability, conflicts of interest, and market concentration concerns can be especially significant.

Depository insurance is worth highlighting. It serves both systemic stability and consumer protection functions. It plays an important role in boosting the economy by providing certainty to market participants and comfort to retail customers, encouraging them not to keep their money under the proverbial mattress. The banking/commercial separation doctrine has been justified on the basis that it avoids putting additional pressure on depository insurance. As a general rule (subject to regulation that prohibits linking deposits to, e.g., proprietary trading, as the Volcker Rule in the United States was meant to do), however, depository insurance also creates "moral hazard" for banks, which can take greater risks on the understanding that customers' deposits and their own commercial viability are publicly insured. There have also been concerns about the fact that, if banks could engage in commercial activity and still rely on depository insurance, those public insurers would have to shore up commercial companies in order to shore up their banks, even while having no relevant expertise and no insight as to whether those commercial entities were solvent.

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[13] Wal-Mart was seeking to form a state-based Industrial Loan Corporation, or ILC, not a federally regulated bank, but the point about market concentration is the same. Drawing on descriptions of 20th century, pre-WWII banking and industrial regulation in Germany and Japan, Shull, *supra* note 12, has described additional concerns related to cronyism, anticompetitive behaviour, and interlocking elites as associated with close links between banks and commercial enterprises.

[14] Financial Stability Board, Peer Review of Canada (30 January 2012), online pdf: Financial Stability Board https://www.fsb.org/wp-content/uploads/r 120130.pdf.

Fintech[15] and the changing environment for banking

Background conditions in each jurisdiction

Every jurisdiction considered here has established a regulatory regime geared toward bank licensing. In other respects, however, financial regulatory structure varies between jurisdictions. Some jurisdictions adopt, or mostly adopt, the traditional entity-based regulatory divide between banking, securities, and insurance, as Canada does. These are the United States and Japan (though Japan has recently floated the possibility of moving to a new "function-based, cross-sectoral" regulatory approach). Singapore is similar: although it has an integrated financial regulator, the Monetary Authority of Singapore (MAS), which also performs other functions such as providing emergency liquidity support as a lender of last resort, the MAS contains a distinct bureau responsible for banking licensing and regulation in particular.

Of the five jurisdictions discussed here, a formal banking/commercial separation doctrine has operated in the three jurisdictions above: in the United States, at the federal level; in Japan; and in Singapore. Although the prohibition is quite clearly stated in each of these jurisdictions, each one also permits banks to engage in additional business lines that are "ancillary" or "closely related" to banking, as noted in Appendix 1 (under the column headed "definition of banking business"). Each has also imposed limits on the amount that a bank, through a subsidiary, could own of a non-financial business, as noted in Appendix 2 (under the column headed "caps on non-financial ownership?").

As with licensing, some of the jurisdictions in which the banking/commercial separation doctrine applies are modifying those rules. None of these three jurisdictions has eliminated the separation doctrine entirely, but it is being relaxed in both Japan and Singapore. The first two columns of Appendix 2, attached, detail these changes. A more comprehensive review of regulatory change in all jurisdictions is provided in Appendix 3.[16] Note that the perceived move into genuinely commercial, non-financial business lines is still relatively minimal. In Japan, for example, regulatory change still seems to contemplate banks moving only into adjacent financial business areas. Singapore is now the only jurisdiction that explicitly permits banks, under certain conditions, to sell consumer goods outright. (Overall, Japan's reforms are more extensive, and there may be more change to come.)

By contrast, for historical and path-dependent reasons, there is little indication that the American federal banking regime is likely to move away from the banking/commercial separation doctrine anytime soon.[17] The most salient regulatory change in that jurisdiction concerns the creation of

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[15] I adopt the Financial Stability Board definition of fintech, also endorsed by the Basel Committee on Banking Supervision (BCBS) and others, as "technology-enabled innovation in financial services that could result in new business models, applications, processes or products with an associated material effect on the provision of financial services." Financial Stability Board, *"Financial Stability Implications from Fintech: Supervisory and Regulatory Issues that Merit Authorities' Attention"* (27 June 2017) online pdf: Financial Stability Board https://www.fsb.org/wp-content/uploads/R270617.pdf.

[16] Appendix 3 also covers developments in Taiwan. That jurisdiction is not really comparable to Canada's in its general economic structure, so it is not otherwise discussed in this report.

[17] But see Baradaran *supra* note 1010, and Peter J. Wallison, "Why Are We Still Separating Banking and Commerce?" (27 July 2017) online: *American Banker* <https://www.americanbanker.com/opinion/why-are-we-still-separating-banking-and-commerce>, arguing against its continued existence.

“restricted” bank charters, and the role of the federal agencies versus the states in seizing the regulatory field within which fintech companies will operate. The fundamental question there may be to what extent federal bank charters, with their associated banking/commercial separation doctrine, will continue to be relevant. Arguably, substantial fintech business is already beginning to circumvent federal banking regulation, either by relying on competing state-level regulation (ILCs or newer strategies) to become licensed, and/or by entering into partnerships and joint operation agreements with existing, licensed state banks to provide necessary depository and back-office components. The OCC’s controversial move to allow “restricted” banks charters reflects its concern about remaining relevant as a regulator.

The other two jurisdictions considered, Australia and the UK, operate “twin peaks” regulatory regimes.[18] A twin peaks approach was adopted first in Australia, and then, after the financial crisis, in the UK. Other jurisdictions have moved to it since, including the Netherlands and most recently, in 2018, South Africa. The main argument for the twin peaks approach is that as a result of technological and business process change, there has been a “blurring of boundaries” across the traditional entity-based industry sectors of banking, securities, and insurance, with the result that regulation was becoming ineffective. The implication is also that banks are less “special” than they once were.[19] Thus, rather than having three entity-based regulators with jurisdiction over the three traditional financial sectors (banking, securities, and insurance), the model provides for two cross-sectoral regulators: one responsible for prudential regulation, and one for market conduct / consumer protection, both of which operate across all three industry sectors.

In Australia, responsibility is allocated between the Australian Prudential Regulatory Authority (APRA), which carries out prudential regulation, and the Australian Securities and Investment Commission (ASIC) with regard to market conduct and consumer protection regulation. In the UK, the “twin peaks” are the Prudential Regulatory Authority (PRA), a division of Bank of England; and the Financial Conduct Authority (FCA), for market conduct and consumer protection matters.[20] The traditional prudential concerns of banking regulators remain, predictably, with the prudential regulatory authorities. However, because of the way that regulatory jurisdiction is divided in these jurisdictions, and because of the fundamental concerns about blurring of boundaries and technological change that informs the model, twin peaks jurisdictions tend not to have a banking/commercial separation embedded in statute or regulation.

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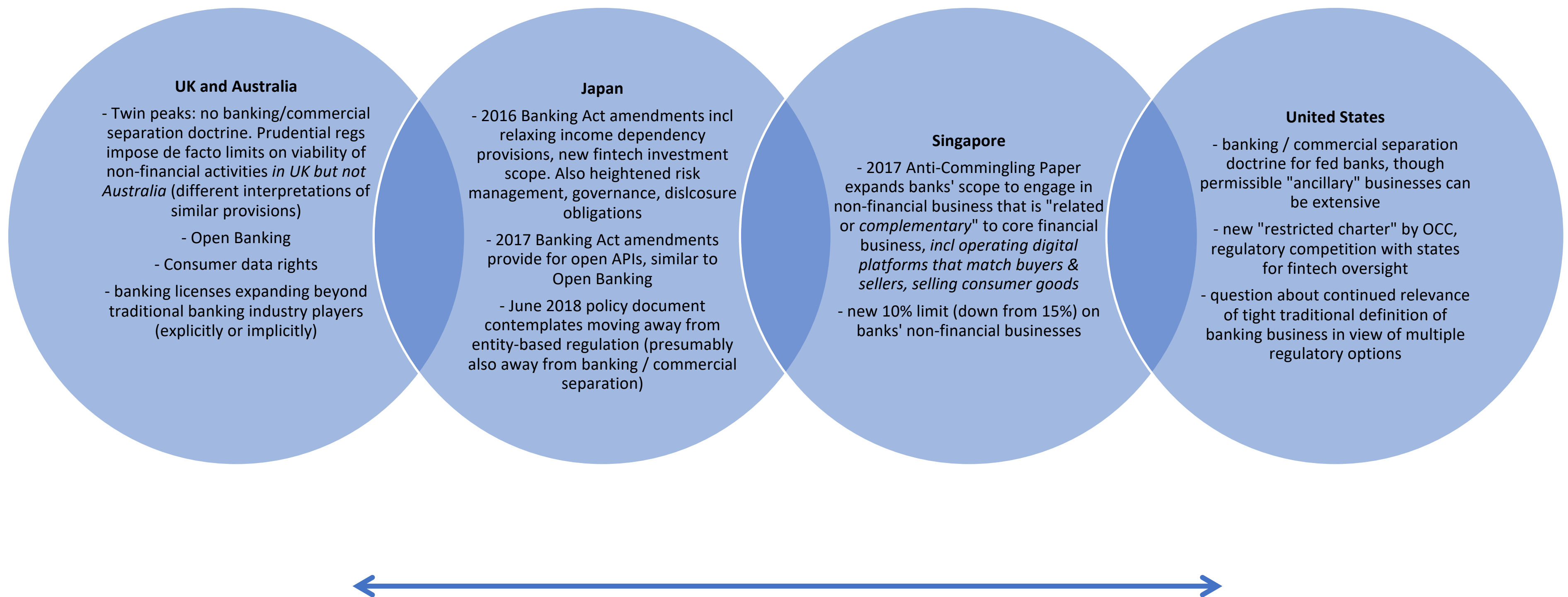
[18] The “twin peaks” model was developed in a 1995 paper by Michael Taylor, then an academic and former Bank of England staffer. Michael Taylor, “Twin Peaks: A Regulatory Structure for the New Century” (December 1995) online pdf: *Centre for the Study of Financial Innovation* <https://static1.squarespace.com/static/54d620fce4b049bf4cd5be9b/t/55241159e4b0c8f3afe1d11e/1428427097907/Twin+Peaks+A+regulatory+structure+for+the+new+century.pdf>.

[19] See also Michael Taylor, “Twin Peaks Revisited… a second chance for regulatory reform” (September 2009) online pdf: *Centre for the Study of Financial Innovation* <http://static1.squarespace.com/static/54d620fce4b049bf4cd5be9b/t/55241044e4b03769e017208a/1428426820095/Twin+Peaks+Revisited.pdf>; Ricks, *supra* note 5.

[20] Banking in the UK is also subject, as of this writing, to European Union (EU) Regulations, and it has “transposed” key EU Directives into its domestic law. EU institutions have directive and incentive powers. Most activity and most regulation, including bank licensing, still takes place at the member state level. This report only discusses EU Directives to the extent that they are apply in the UK as of the date of the report. The interaction between EU and member state law is complicated, and a more comprehensive treatment of EU law in banking is beyond this report’s scope.

These five jurisdictions rely on the banking/commercial separation doctrine to different degrees. Arrayed along a spectrum, with no reliance on the banking/commercial separation doctrine at the left, to the greatest reliance on it at the right, it might look like this:



Spectrum: Jurisdictions described in terms of the centrality of the banking/commercial separation doctrine to their regulatory regimes, with least reliance on the left and most reliance on the right.

Hot topics affecting the "business of banking" today – what might be "commercial"?

At this point, the "hottest topics" touching on banking and fintech generally, across these jurisdictions, seem to be focused on: banks' and financial institutions' ability to deploy data; their ability to develop and/or compete or collaborate with retail payment systems for e-commerce,[21] with associated requirements to ensure data security and to manage operational risk; Application Programming Interfaces (APIs), which are the software "plug" to securely connect one set of data with another program; and Open Banking (whether it is encouraged or, as in Australia and the UK, mandated).[22]

Banks see opportunities associated with technological change, particularly around the deployment of data, the creation of software APIs, and the commercialization of back-office operational systems. For example, if banks are permitted to sell products and services they have developed in-house, they could participate in all aspects of the retail payment system infrastructure, and provide their products and services to third parties. As well, APIs are the backbone of Open Banking initiatives, but APIs are used whenever a software application connects to a user (e.g., when I look for things "near me" on google maps). Another significant opportunity could be around the commercialization of banks' risk analytics, governance, and management systems, including those designed to manage operational risk associated with outsourcing of key functions to Third Party Providers (TPPs), something that is done by any number of potential non-financial customers. So far, there seems to have been considerably less interest in selling physical products such as "smart appliances".[23]

Significantly, many of these new business opportunities are still basically financial, rather than purely commercial, in nature. Note that financially-based businesses, even including e.g., the permission Singapore has given banks to create digital platforms that match buyers and sellers of consumer goods, still fall under financial, and thus not non-financial commercial, activity. That kind of business is already happening, at least in jurisdictions such as the UK (see, e.g., HSBC's we.trade product).

Within this in mind, it is worth considering what exactly would be prohibited by the banking/commercial separation doctrine, where "commercial" means truly *non-financial*

[21] A helpful article on the changing retail payments environment is Adam Levitin, "Pandora's Digital Box: The Promise and Perils of Digital Wallets" (2018) 166:2 U PA L Rev 305-376.

[22] Although it is not part of this project's narrow remit, Open Banking initiatives are probably the most significant regulatory changes in Australia and the UK (where the UK follows EU directives). In these jurisdictions, Open Banking platforms have been struck in response to the perception that banks are serving customers poorly, and are taking advantage of their market power. The UK has also developed other initiatives geared toward opening up the banking sector to "challenger banks" – notably a new requirement that the UK's nine largest banks pass on the details of small businesses they have turned down for finance to three Government designated finance platforms, so they can seek potential funding from other lenders; and HM Treasury's direction to the British Standards Institution to create a guidance document to support FinTechs in engaging with legacy financial institutions.

[23] Before the financial crisis, even car manufacturers' businesses centred more around car loan financing and back-office financial arrangements than around profits derived from the actual manufacture and sale of physical vehicles. In 2004, eighty percent of General Motors' profits derived from its financial arm, General Motors Automotive Bank (GMAC) (which, of course, had to be bailed out during the financial crisis). Lauren Etter, "Is General Motors Unraveling?" Wall St. J., April 8, 2006, at A7. The car companies have moved substantially out of the financing business in the years since the financial crisis, such that financing accounted for only slightly more than 8% of GM's revenues in 2017. Revenue from GM Financial as a percentage of Total Revenue, GM 2017 Annual report, p. 46.

commercial activity. Most of the hot topics above substantially fit within the existing boundaries of financial services. Only a smaller section is likely truly "commercial," in the sense of not being financial *and* not being ancillary to carrying out a financial business. The table below draws the distinction. For a concrete sense of what non-financial commercial businesses banks may branch out into in future, the large Australian banks' websites are especially helpful (see, e.g., the footnote to Westpac's principal investments immediately below).

Fintech that falls under "finance" or other permitted activities and is already being done, or could be done	**Some examples of "fintech" or deployment of fintech, which might extend beyond finance to "commercial activities"**
Investing in new (financial and non-financial) tech companies through commercial partnerships, as RBC Ventures Inc.,[24] BMO,[25] Scotiabank;[26] or investing through IP support and licensing, as TD [27] does; or providing data lab for university co-op students, as CIBC[28] does. (More activities undertaken through US state-based subsidiaries / sister companies, not covered at these links.)	Investing directly in new tech companies without the need for a commercial partnership agreement, as the large Australian banks (see e.g., Westpac[29]) do – ventures include startups for "optimising on-farm efficiencies," matching customers with local real estate agents; other partners and investments cover AI-powered data analysis, "quantum technology that encrypts confidential data," software for preventing and solving crime, a local social media platform, and more
Using data generated from customers' banking activity to sell them other financial products and services – e.g., refer them to their brokerage or trading arms, target them better for the sale of particular insurance or investment products, etc. - Could be augmented by large-n or "big data" trend analysis	Using data generated from customers' banking activity, including large-n or "big data" trends, to sell them non-financial products and services – various

[24] "Ventures", online: *RBC Ventures* <https://www.rbcventures.ca/ventures/en>.
[25] "BMO Partners with BioConnect to Launch Biometric Authentication Platform for Commercial and Corporate Clients" (Last modified 22 October 2018), online: *BMO* <https://newsroom.bmo.com/2018-10-22-BMO-Partners-with-BioConnect-to-Launch-Biometric-Authentication-Platform-for-Commercial-and-Corporate-Clients>.
[26] Diana Hart, "Going Global: the Power of Partnering with LatAm Startups", online: *Scotiabank* <https://www.scotiabank.com/corporate/en/home/media-centre/media-centre/going-global-the-power-of-partnering-with-latam-startups.html>.
[27] "TD Extends $30 million Fintech Investment Pool to Unique Patent Program", online: *TD* <http://td.mediaroom.com/2017-10-04-TD-Extends-30-million-Fintech-Investment-Pool-to-Unique-Patent-Program>.
[28] Armina Ligaya, "CIBC launches data lab in Waterloo to harness fintech talent", *Financial Post* (11 May 2017), online: <https://business.financialpost.com/news/fp-street/cibc-launches-data-lab-in-waterloo-to-harness-fintech-talent>.
[29] "Principal Investments", online: *Westpac Banking Corporation* <https://www.westpac.com.au/about-westpac/innovation/principal-investments/>.

Matching buyers and sellers: e.g., WeTrade (HSBC’s product), which sets up the payment platform that matches buyers and sellers of goods, e.g., wholesale or retail olive oil	Using data generated from matching buyers and sellers to advertise or promote other products (for a fee): e.g., WeTrade offering balsamic vinegar to buyers of olive oil
E-commerce and retail payments utilities: creating APIs that link financial data to other platforms and services (like competitor to PayPal, ApplePay, or perhaps to credit cards)	Using bank-based electronic payment systems, which capture extensive information about consumer purchasing practices, to provide additional non-financial services (e.g. loyalty programs, dispute resolution services, product reviews)
New clearing and settlement infrastructure (using distributed ledger technology or otherwise) for wholesale clearing and settlement, securities ownership trail, other	Commercially building out and marketing clearing and settlement infrastructure abroad
Building cyber-security and system integrity/supervision/governance tools (including using biometrics), or customer due diligence tools, based on banks’ expertise, infrastructure, and access to data	Marketing cyber-security and system integrity/supervision/governance tools (including e.g., using biometrics), or customer due diligence tools, to non-bank users
Building and selling other finance-related consulting services based on banks’ access to data. e.g., investment advice (including to some extent via “robo-advisors”), consumer-facing trading services, debt management tools, spending tracking and budgeting software - Could be augmented with machine learning-based tools	Building and selling other non-financial consulting services based on banks’ access to data. E.g., research services?
Creating new crypto-assets, or investing in them.	Offering business advice or consulting services to crypto community?
Creating distributed ledgers that can be useful for completing financial transactions, improving record keeping.	Using bank-created distributed ledger-based technologies as a foundation for a broader set of “smart contracts” that could be made available to Canadian individuals and institutions, potentially disintermediating many common transactions as well as e.g., wills and probate, divorce settlements, other.

	Selling distributed ledger structure to other bodies that require incorruptible record-keeping – e.g., health services, police, etc.
Creating or investing in other kinds of financial products that depend on new technology: e.g., new mechanisms (including on the blockchain) for remittance and other cross-border transactions, new mobile money or mobile banking tools for use within Canada and abroad.	Using data created by remittance and other cross-border transaction information to sell people geographically-targeted products (e.g., news feeds, flights, SIM cards). Selling distributed ledger system to international shippers, border security, other entities with cross-border record-keeping and settlement needs beyond the financial
Developing commercial arbitration platforms in case of disputes associated with bank functions (e.g., robo-advising or trading, challenges to payment system or settlement when matching buyers and sellers on a platform like WeTrade) - Could be augmented with machine learning-based tools	Expanding bank-created dispute resolution tools to broader dispute resolution context (including private commercial dispute resolution beyond the bank context, e.g., between clients, on a fee-for-service or subscription basis); and providing associated professional, including legal, advice.
Selling customers' data (because data as an asset, in the same way that office furniture is an asset)	Developing business lines based on selling customers' data to third parties

Looking at the difference between fintech activity already being carried out, and non-financial commercial activity in the right-hand column, it is not obvious that the line between them constitutes a clear line between safety and fragility. Extensions as imagined in the right-hand column are potentially significant, in consumer protection and systemic stability terms, but this is because of their potentially enormous reach, not because of their "commercial" nature.

It is therefore not obvious what function the banking/commercial separation doctrine in particular is serving, as compared to, for example, general banking regulation that is geared explicitly toward ensuring that all of a bank's business conduct is subject to prudential, customer protection, and pro-competitive regulatory provisions.

Technological change, the financial crisis, and prudential regulation

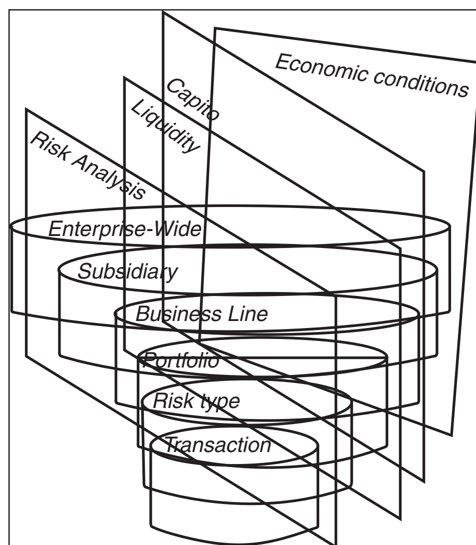
The table above suggests that the "hot topics" of today do not necessarily engage the banking/commercial separation doctrine that much; on its own, this does not mean that the doctrine is not still important. Recent change to the business of banking, however, and new learning from the hard experience of the financial crisis, suggest that the banking/commercial separation doctrine may no longer be the ideal tool for addressing these concerns.

As noted above, one of the historical justifications for the banking/commercial separation doctrine centred around mitigating systemic risk, and limiting access to the particular privileges (depository insurance, LOLR liquidity support) that banks enjoyed because of states' efforts to limit systemic risk. But one of the key lessons from the financial crisis has been that non-bank financial businesses can be every bit as systemically significant as bank businesses, and that risk and contagion can spread across the financial sectors of banking, securities, and insurance. By necessity in the acute phase of the crisis, governments extended massive emergency liquidity support, and acted as LOLR, to many institutions that were not traditional banks. The boundaries could not be maintained. Since the financial crisis, it has therefore been recognized that safeguarding systemic stability requires that regulators and governments bring a wider lens to their task. If governments may potentially be expected to provide support to institutions beyond their pure banking functions, then prudential standards should logically apply across all potentially relevant business lines.

Prudential regulation – which applies across all five jurisdictions discussed here – has deepened and evolved over the past few decades. Prudential provisions now apply not only to traditional banks, but also in many cases to financial institutions as a whole. They encompass considerable governance, prudential / safety and soundness standards, and resolution provisions, and they do so on explicit, transparent, and principled grounds. Financial stability regulators such as the Bank of England, the European Central Bank, and the US Federal Reserve have gained regulatory and supervisory powers since the financial crisis. Contemporary analytical methods are both extensive and qualitatively sophisticated. New prudential tools, not available when the banking/commercial separation doctrine was entrenched in US federal law in the 1950s (let alone earlier), are now available.

Consider stress testing, an approach that has been adopted across most jurisdictions with respect to at least the largest financial institutions. As the diagram below illustrates, stress testing can deploy data to assess risk along multiple different axes, producing a comprehensive and nuanced understanding of an institution's resilience, and likely addressing systemic risk concerns much more accurately than the bright-line banking/commercial separation doctrine could do: [30]

[30] Figure from Michael P. Malloy, "Stressing Out: New Guidance on Stress Testing for Large Banking Organizations" (2012) 31:8 *Banking & Financial Services Policy Report* 1, at 3 (describing the US OCC, Fed & FDIC Guidance on Stress Testing. US OCC, the Federal Reserve & FDIC, Notice, "Supervisory Guidance on Stress Testing for Banking Organizations with More Than $10 Billion in Total Consolidated Assets" (17 May 2012) 77 Fed Reg 29, 458). Section 165(i) of the *Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA)*, Pub L No 111-203, 124 Stat 1376, 1431-1432, § 165(i) (2010) (codified at 12 U.S.C. § 5365(i)), requires specified companies to conduct annual stress tests pursuant to regulations prescribed by their respective primary financial regulatory agencies.



At the same time, banking regulation is no longer concerned with preventing any failures ever, for fear of not being able to control them.[31] Prudential regulation can be too onerous if it prevents banks from engaging in the liquidity, maturity, and credit transformation functions that help power the economy. Since the financial crisis, it has been generally recognized that regulation's main concern should be mitigating the systemic, macroprudential risks, including contagion risk, associated with particular institutions' failure – not with any institution's failure on its own.[32] In this regard, too, regulatory thinking has moved away from a binary, bright-line approach to one that considers a bank's business within a larger context, by reference to the risks it presents to the system as a whole.

The UK versus Australia: Interpreting prudential requirements differently

In practical terms, these prudential regulatory requirements have the potential to do much of the work that bright-line scope-of-business prohibitions, i.e., that the banking/commercial separation doctrine, would have aimed to do in the last century. The prudential regulatory requirements to which banks are subject can be interpreted to impose real restrictions on the activities in which a bank engages. Apparently, they are interpreted in this restrictive way by at least some major banks in the UK. However, substantially identical provisions are not interpreted in this way by at least some major banks in Australia.[33] As "twin peaks" jurisdictions, neither the UK nor Australia has a banking/commercial separation doctrine. In any jurisdiction that is considering softening or eliminating that doctrine, these jurisdictions' divergent experience with the impact of prudential regulation merits attention.

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[31] See, e.g., UK Bank of England, Prudential Regulatory Authority, *"The Prudential Regulation Authority's approach to banking supervision"* (31 October 2018), online pdf: <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/pra-approach-documents-2018> at 6 ("it is not our role to ensure that no firm fails. Therefore, a key principle underlying our approach is that we do not seek to operate a zero-failure regime. We work with the Bank of England … as UK resolution authority to ensure that any firms that fail do so in an orderly manner.")

[32] Armour et al., *supra* note 3 at 292-93.

[33] The below is based on confidential conversations between the author and individuals within large UK-based and Australian banks.

From their inception, the Basel Capital Adequacy Accords have sought to develop prudential standards for international financial institutions, to help establish a baseline set of protections against the main kinds of risks run by those institutions. In particular, they were expected to observe capital requirements and maintain liquidity buffers to address *market risk* (mainly, the risk that the market for particular investments will go down – something that carries many serious knock-on effects for leveraged institutions), and *credit risk* (essentially the risk that counterparties will default or not fulfill a contractual agreement, or that borrowers will not repay a loan). The Basel II Accords, published in 2004, required for the first time that international financial institutions also account for *operational risk* (meaning the failure of people or processes, including such risks as cybersecurity breaches, internal fraud, or the like – all things with potential relevance to non-financial businesses). They also required that institutions' balance sheets report *all* the institutions' businesses on a *consolidated* basis. While not legally binding themselves, the Capital Accords are accepted, essentially mandatory, practice for any international financial institution, and they have been incorporated into domestic standards across most of the world.

Basel II's provisions explicitly applies as a matter of formal law to UK banks, because those provisions were incorporated into EU Directive 2006/48/EC. This Directive extended Basel provisions to all member state banking institutions and not just those involved in international banking. The large majority of this Directive was, in turn, incorporated into UK law.[34] In 2013, Basel III produced another round of reforms, but not reforms that altered the basic shape of the Basel II requirements around consolidated financials. The EU's 2013 CRD IV (reflecting changes arising from Basel III), for example, do not change the consolidation requirements. Indeed, Basel II's provisions have been strengthened through new post-financial crisis requirements around capital adequacy (minimum capital requirements plus, under Basel III, capital buffers), liquidity, internal risk management, institutional resilience as assessed through stress testing, and orderly resolution regimes.

As a functional matter, this has reportedly had a profound impact on UK banking business. At least some and perhaps most, or even all, large UK-based banks have interpreted the prudential regulatory provisions, and the requirement that financials be consolidated, to mean that they would have to operate any commercial business as if it was a banking business. That is, the bank would have to comply with capital adequacy, liquidity, risk management, and other regulations in regard to the commercial business, as with the bank as a whole. Because of the cost overhang this imposes, running a non-financial commercial business has been perceived within at least some large UK-based banks to be economically non-viable. A bank-owned chain of coffee shops, for example, would not be competitive with a chain of coffee shops not owned by a bank.

The UK's ring-fencing initiative, which came into effect on 1 January 2019, has likely changed this situation for UK banks in the sense that now, depository banking business must be fully

[34] Incorporation was done via the Prudential Handbook of the FSA (as it then was), GENPRU and BIPRU sections: *see* UK, HM Treasury, *"Transposition Table: Implementing Directive 2006/48/EC (Banking Consolidation Directive)"* (5 January 2010), online: <https://www.gov.uk/government/consultations/implementing-amendments-to-the-capital-requirements-directive>. Relevant sections require that "credit institutions" (aka banks) report on all activities, and maintain capital etc., on a consolidated basis, are Articles 71, 75, 125-127, 133, and 134 of the EU Directive. For some additional explanation, *see* Andrew McKnight, "Basel 2: the implementation in the UK of its capital requirements for banks" (2007) 1:4 Law and Financial Markets Review 327-340.

walled off from other business lines. Banks in the UK therefore now have a choice about how to treat any non-financial businesses in which they engage. In the very unlikely event that a commercial business could somehow be located "inside the ring-fence," alongside depository banking functions, that business would have to be consolidated for financial reporting purposes. The full suite of prudential regulatory obligations would presumably apply. If the commercial business were "outside the ring-fence," then it would be a separate business and required to operate at arm's length from the depository banking business, completely without access to any of the distinctive privileges that banks enjoy.[35] Functionally, what this means is that ring-fenced UK banks will not be engaging in non-financial commercial activity and, in fact, will not be engaging in some forms of financial activity either; those businesses will move to entities outside the ring fence. This likely substantially addresses the systemic stability and consumer protection concerns, described above, that underpin the banking/commercial separation doctrine.

In Australia, by contrast, prudential regulation has not had the same effect. The difference seems to be largely a matter of interpretation. Australian banks (licensed as "authorised deposit-taking institutions", or ADIs) do not read the prudential regulatory requirements that apply to them in a way that constrains their investments in non-financial businesses. On the contrary, they have been making many such investments. Australia has a concentrated and mature banking market, within which margins on key business lines are small, and shrinking. Reportedly, the view among all four of Australia's large banks is that "unless they diversify their businesses, they will not survive".[36] Those ADIs are leveraging their data and systems expertise to engage in a range of non-financial commercial ventures.

The Basel Capital Accords have been substantially adopted in Australia, with some relatively minor modifications.[37] They are implemented through prudential standards developed by APRA.[38] Along with the common capital adequacy, liquidity, risk management and governance requirements, another standard, discussed further below, that would be relevant to an Australian ADI's non-financial commercial subsidiary would be Prudential Standard APS 222 "Associations with Related Entities".[39]

Significantly, it seems that Australian ADIs read the bulk of these prudential standards as simply not relevant to a subsidiary that does not take deposits, and does not make loans. The view is that such a subsidiary is not running market risk or credit risk to any significant degree. (If the ADI invested some seed capital in a commercial start-up, credit risk would be relevant. So far, such investments have not been large.) Effectively, the only risk that generally would apply to an ADI's non-financial subsidiary would be *operational risk,* which is also understood to capture reputational risk and governance risk. The interpretation is simply that the other prudential regulatory obligations do not apply.

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[35] For more information see *"The Financial Services and Markets Act 2000 (Ring-fenced Bodies and Core Activities) Order 2014"* (UK), SI 2014/1960.
[36] Per Australian bank employee, *supra* note 33.
[37] Reserve Bank of Australia, Financial Stability Review – September 2013 "Box B: The Basel III Capital Reforms in Australia" at https://www.rba.gov.au/publications/fsr/2013/sep/box-b.html.
[38] The standards and guidance that apply to ADIs are on APRA's website at https://www.apra.gov.au/adi-standards-and-guidance.
[39] The version currently in force is at https://www.legislation.gov.au/Details/F2014L01654. A revised version, set to come into force on 1 January 2020, along with associated forms and discussion paper, is available at https://www.apra.gov.au/revisions-related-parties-framework-authorised-deposit-taking-institutions.

Moreover, since ADIs (that is, Australian banks) generally report their financials on a consolidated basis, any calculations the ADI makes about e.g., the operational risk associated with a new data company in which it has invested would be rolled into overall consolidated reporting, not broken out or visible on the face of the document. Unlike the fine-grained analysis that goes into the rest of the reporting on e.g., credit risk and the calculation of capital, operational risk assessments apparently tend to be quite crude. The result is that any capital set aside to cover the risks associated with a non-financial commercial business would tend to be largely invisible, and only quantified in a "ballpark" fashion.

It is not clear why UK and Australian banks would interpret similar provisions so differently. The Australian interpretation seems more logical, strictly speaking, in terms of the primary kinds of risk that a non-financial commercial subsidiary might be running. It is the British interpretation that is more difficult to explain. Regulatory and industry culture (including the City's famous set of informal norms)[40] may play a role. Regardless, ring-fencing in the UK will change the ground rules, and may well open the door to UK banks engaging in new business lines "outside" the fence.

The Australian interpretation is insufficient, however, if the concern is defending against the systemic risk and consumer protection concerns that produced the banking/commercial separation doctrine. In the event that one of the four large Australian ADIs engaged in non-financial commercial business, of a sufficient magnitude to potentially affect its overall viability and therefore potentially systemic stability in Australia, it is not certain that the ADI would have adequate safety and soundness strategies in place to manage those risks on its own.[41] Unlike the ring-fencing arrangement now in place in the UK, Australian depository insurance and LOLR mechanisms would potentially be exposed as a result. Similarly, without a detailed sense of the magnitude of an ADI's non-financial commercial business or its relationships to the ADI's traditional banking functions, it is very difficult to determine whether conflicts of interest or market concentration concerns are present. Both have the potential to undermine consumer protection.

Regulators may persist in thinking "a bank is a bank is a bank"

Australian regulatory requirements are silent with respect to Australian banks' interpretation of the prudential requirements, perhaps because the non-financial commercial businesses that Australian banks are running are still so new and relatively small. Notwithstanding the changing nature of the banking business in Australia, APRA prudential standards do not require ADIs to capture even the operational risks associated with their non-financial commercial businesses in a comprehensive or transparent way.

For example, Prudential Standard APS 222 requires ADIs to "give due consideration to the risks associated with the corporate group of which they are a member and to ensure they are not exposed to excessive risk as a result of their associations and dealings with related entities".[42]

[40] See, e.g., John Armour & David Skeel, "Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of US and UK Takeover Regulation" (2007) 95 Geo. LJ 1727.
[41] In case this sounds far-fetched, consider Enron – a corporation whose generally viable energy business was swamped, in size and risk, by its financial business. In Australia as of 1 January 2020, as noted in Appendix 2, ADIs must *notify* APRA prior to "committing to any proposed exposure to a related entity that is greater than, or equal to, 10 per cent of the ADI's Tier 1 Capital."
[42] See *supra* note 39.

Under the version of APS 222 currently in force, the related entities on which an ADI must report are clearly only financial businesses. The Standard and associated disclosure form requires that ADIs report on their banking subsidiaries (Australian-owned, foreign subsidiaries, branches of foreign banks), building societies, credit unions, and "other ADIs" – but a genuinely commercial, non-financial business would of course be none of those things. This is not to say that an ADI could not operate a commercial, non-financial business; only that if it did so, the forms do not contemplate that the ADI report on that business.

A proposed revised version of APS 222 is set to come into force on 1 January 2020.[43] Under it, Australian banks will have slightly augmented obligations to disclose risks of commercial businesses they undertake. The standard and its associated disclosure form require that ADIs report their *twenty largest exposures* to related entities, which are now divided into "banking, insurance, superannuation, SPV, other financial institution, and other counterparties".[44] "Other counterparties" is defined to include "any related entity that is not a banking institution, an SPV, insurance corporation, superannuation fund or other financial institutions". To the extent that a bank's non-financial commercial business is a counterparty, *and* is within the bank's twenty largest exposures, it would therefore be included. However, there is no residual "other related entities" category. A non-financial, commercial related entity that is not a "counterparty", at least in the strict sense of being on the other side of a contract, would not be included even if it was within the bank's twenty largest exposures.

In view of the changing nature of banking, APS 222 seems limited in its coverage. It may not capture all the businesses that banks will be engaging in, at scale, in five years' time. In other words, "APRA still thinks a bank is a bank is a bank".[45] At a minimum, applicable prudential standards should require banks to be more transparent about the risks (operational and otherwise) associated with the non-financial commercial businesses they are running. To the extent that those businesses could become sizeable and could impact stability in the banking sector, due consideration of those risks on the bank's part, and disclosure of the extent of that due consideration, are important. Greater guidance about precisely which risks are relevant to a non-financial commercial business (i.e., about whether the existing Australian or UK industry interpretations should govern) would also be useful.

Protecting consumers, avoiding conflicts of interest, minimizing market concentration

The other main historical justification for the banking/commercial separation doctrine has been the need to protect customers, by limiting conflicts of interest on the part of banks, promoting competition within the sector, and controlling market concentration. In fact, concerns about conflicts of interest, market power, and market concentration vis-à-vis banks in particular may be less severe today, because of the multiple non-bank means by which businesses can now access capital – at least in those jurisdictions where the banking and financial sector are competitive and

[43] Ibid.: see APRA, "Revisions to the related parties framework for authorised deposit-taking institutions" (July 2018): https://www.apra.gov.au/revisions-related-parties-framework-authorised-deposit-taking-institutions. The comment period has closed. Similar standards for reporting in relation for large exposures have already come into force.

[44] See the Draft Reporting Standard ARS 222, at https://www.apra.gov.au/sites/default/files/draft_reporting_standard_ars_222.0_exposures_to_related_entities_july_20.pdf.

[45] Per Australian bank employee, *supra* note 33.

not excessively concentrated. Given that there are multiple players in the space today, this suggests that that sector-specific prohibitions on banks specifically engaging in commercial business may no longer make sense. Two things would seem to be essential, however: one would be establishing a level playing field, which treated equally all institutions that provided access to finance, that played systemically important roles within the financial markets, and that had access to customers' data; and the other would be to ensure that competition was not stymied because of (formal or informal) barriers to entry, or anticompetitive conditions that unduly favour incumbents.[46]

A June 2018 policy document from Japan's regulator, the Financial Services Agency, captures the contemporary shift in regulatory approach, toward a more comprehensive perspective that relies especially on prudential regulation. The report suggests that "[t]here is room to reconsider the focus placed on regulations on scope of permissible business of banks and banking groups", that banks and other business companies should be able to "compete on an equal footing basis, with attention to the differences in the effectiveness of avoiding risk in other business to the basic lines of business of banks", and that it will be necessary "to update prudential regulations which accommodate risks of new types of business" and "to consider whether objectives and coverage of safety nets may change".[47]

Building in safeguards to address the concerns underlying the separation doctrine

The above suggests that the traditional banking/commercial separation doctrine had more salience in the 19th and 20th centuries than it does today. It is increasingly artificial, and indeed could lead to suboptimal regulatory policy, when one considers the substantial risks that also flow from a bank's participation in other, financial (as opposed to non-financial commercial) business lines. A more comprehensive, more direct, and more transparent mechanism is required to get to the root challenges of ensuring systemic stability, and protecting consumers. Across the jurisdictions surveyed here, the following three general strategies stand out:

1. Safeguarding systemic stability: the nexus between special banking privileges and regulatory oversight

The special privileges that banks have traditionally enjoyed, such as access to deposit insurance and LOLR liquidity support, exist to serve systemic stability functions and to ensure the economy continues to function well. These special privileges should not be extended to cover large swaths of the economy, and should not be extended beyond the purposes for which they exist.

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[46] See, e.g., the discussion of the New Payments Platform in Australia at Appendix 3.

[47] Japan, Financial System Council, Study Group on the Financial System, *Toward function-based, cross-sectoral financial regulations* (Provisional translated Interim Note) (19 June 2018), online pdf: <https://www.fsa.go.jp/en/refer/councils/singie_kinyu/20180619/gaiyou_eng.pdf>. Underlying full report available in Japanese only. The JFSA's interim discussion paper has not yet produced concrete outcomes, and it is more ambitious than anything being contemplated in Canada in that it considers the value of a move away from an entity-based regulatory framework toward more "function-based, cross-sectoral" regulation (which suggests a twin peaks regulatory structure or some other wide-ranging reform), "in light of unbundling and rebundling … to apply the same rules to activities within the same functions and risks".

In this regard, banking licenses remain a meaningful hurdle. They impose valuable entry requirements on institutions that want access to deposit insurance and other banking privileges. It is also generally recognized that being a licensed and recognized "bank" has a strong signaling effect for consumers. New "restricted" licenses may serve a useful function in ensuring adequate competition exists within the banking sector, and in ensuring that barriers to entry do not cause fintechs to avoid banking regulation altogether (thereby depriving their customers of deposit insurance, and increasing systemic fragility). In both the United States (OCC) and Australia, however, regulators have been cautious in extending restricted licenses. In the UK, which has established a "new bank startup unit" and provided other mechanisms to help fintechs enter the banking business (see Appendix 3), actual licensing provisions seem not to have changed at all. In that jurisdiction, it appears that regulatory support is being used to help challenger banks – of which there are a number – meet existing licensing standards.

There is a balance to be struck between ensuring competition in the banking sector, for consumers' sake, and maintaining the safety and soundness standards that safeguard systemic stability and depository insurance. To the extent that fintech companies are able to circumvent OCC regulation in the United States because of that country's fractured regulatory structure, while still having access to FDIC depository insurance, for example, there are risks. However, the choice of federal or state regulation is less important than ensuring that the financial institution in question remains subject to prudential and consumer protection requirements. The banking/commercial separation doctrine, as a component of OCC regulation, is less important today than the prudential standards to which deposit-taking institutions should remain subject.

Particularly in the wake of the financial crisis, systemic stability considerations also suggest that banks, which enjoy the benefits associated with licensing and state support, should potentially be subject to prudential requirements that apply across all business lines and not only their banking arms. This has been the case in the UK, following the Basel II Capital Accord's functional implementation into UK law. Under UK ring-fencing, the benefits associated with licensing and state support will be further targeted toward the explicit domestic deposit-taking and loan-making traditional banking functions. By contrast, it does not seem that prudential regulatory standards are accomplishing the same goals in Australia, as a function of industry interpretation of the standards and regulatory acceptance of the status quo.

Note that this report does not suggest that existing prudential regulatory standards, even interpreted in the comprehensive UK fashion, are necessarily sufficient to address new risks that may flow from banks engaging in commercial activity. As Japan's FSA observed in June 2018, it will be necessary to update prudential regulations, and to consider the adequacy of existing safety nets, in order to accommodate the risks flowing from having banks engage in new types of business.[48] The kinds of risks that are triggered by large-scale data-based businesses (of the kind the Australian banks may soon be contemplating) may be different in kind and in magnitude from what prudential standards currently contemplate. This report suggests, only, that using sufficiently robust prudential tools, which adequately cover a bank's businesses, is more in line with evolving international practice, and is more principled and direct, than relying on the proxy of the banking/commercial separation doctrine to achieve the same regulatory goals. Clear regulatory guidance about the appropriate interpretation of prudential requirements vis-à-vis commercial businesses, along with explicit transparency and disclosure obligations, seem

[48] See *supra* note 36 and accompanying text; also see Appendix 3 below.

essential to ensuring that banks disclose, and provide for, all the risks they are running which may affect systemic stability and which may require state support in the form of LOLR assistance or deposit insurance.

Existing transparency, governance, and risk governance mechanisms within corporate governance regimes may potentially go some distance to managing the risks associated with commercial or fintech activity by banks. In October 2018, Australia implemented a strong new regime in response to its recent banking scandals.[49] Every jurisdiction discussed here has some corporate governance expectations that apply to financial institutions, although they may not all be equally meaningfully enforced in practice. Nevertheless, corporate governance provisions will not compensate for the absence of regulatory guidance around how to account for non-financial commercial businesses within a bank's overall structure.

2. Consumer protection: data and privacy, consumer protection and back-office concerns

Given what we now know about how central data is to contemporary businesses – financial and non-financial – and given the vast data that banks have concerning their customers, protecting consumers requires that consumers themselves control access to their data, that they understand and consent to the uses to which it is being put, and that banks have effective systems in place to manage the operational and privacy risks that flow from their businesses. The banking/commercial separation doctrine is not responsive to this new consumer protection priority. Existing risk governance mechanisms within corporate governance help to address some of these risks. More comprehensively, as noted in Appendix 3, three of the five jurisdictions discussed in this report (the UK, Australia, and Japan – as well as the EU, which has taken the lead on this initiative) are in the process of implementing some form of Open Banking.

Omnibus statutory duties of confidentiality and/or protection of privacy regimes may also be relevant. All the jurisdictions discussed here have personal privacy and data protection regimes in place, though they may not all be equally meaningful in practice. Among notable recent initiatives, Australia's Productivity Commission has proposed a general "new data framework," whose recommended statutory reforms are clearly relevant to fintech, banking, and personal financial information, even though these sectors are not explicitly mentioned. The Report has recommended that Australians have the benefit of a Consumer Data Right (CDR), a provision which has been adopted by government and which will be applied first to banking sector, through the Open Banking initiative, as of July 2019.[50]

Whether consumer data protection rights are adopted through general statutory reforms or through regulation targeted at financial institutions, there is a need to develop updated consumer protection mechanisms, which go beyond what the banking/commercial separation doctrine can accomplish.

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[49] See Austl, Commonwealth, APRA, Implementing the Banking Executive Accountability Regime (Information paper) (17 October 2018), online pdf: <https://www.apra.gov.au/sites/default/files/information_paper_implementing_the_bear.pdf>.

[50] Austl, Commonwealth, Productivity Commission, *Data Availability and Use* (Report No. 82) (Canberra: online, 8 May 2017).

3. Promoting competition: addressing conflicts of interest and avoiding excessive market concentration

Conflicts of interest would remain of concern in any situation where a bank was also in competition for business with non-bank businesses. Existing banking law provisions address conflicts of interest within the different financial arms of a universal financial institution.[51] Tie-in arrangements in particular have long produced challenges and regulatory responses in adjacent areas, such as securities regulation. However, it does not seem that the specific conflict of interest concern that underpinned the banking/commercial separation doctrine has been comprehensively addressed in any of the jurisdictions reviewed here. That is, the prospect that a bank might withhold funding to a competitor in a commercial space, or might require that customers purchase their product to obtain a loan, seems not to have been considered within banking regulation itself. In the absence of the banking/commercial separation doctrine, specific provisions that clearly extend existing conflict of interest provisions to cover non-financial commercial businesses will be required.

At the same time, it seems fair to say that banks' conflicts of interest are not the only conflicts of interest that could affect customers' and competitors' access to funding today, just as banks are no longer the only source of financing. A comprehensive regulatory response to conflicts of interest beyond banking is beyond the scope of this report. Within the ambit of this project, banking regulators should ensure that they are alive to new conflicts of interest and anticompetitive behaviour within the industry, which arise as a function of new non-financial commercial business lines, and should ensure that existing banking law provisions are effectively enforced.

Open Banking initiatives like those already underway in the EU, the UK, and Australia also help to promote competition and to prevent excessive concentration, and have been well-received by the public in those jurisdictions, perhaps especially in light of the perception that banks have abused their market power in some segments.

Concluding Remarks

Banks continue to be "special," in the sense that they serve an important role in enabling the economy to function, and in the sense that because of that, they have access to special privileges. Licensing continues to be an important mechanism for linking those special privileges with a set of regulatory obligations, around prudential regulation in particular.

The banking/commercial separation doctrine, however, may no longer be the ideal means for addressing the concerns – about systemic risk, and about customer protection – that generated it. Among the jurisdictions reviewed here, most have softened the doctrine. Properly implemented, prudential and governance requirements have the potential to do substantial work in ensuring systemic stability, protecting consumers, and promoting competition within the sector. Of course, as with any regulatory regime, those standards are open to interpretation, including potentially self-serving or short-termist interpretation by industry actors. In the absence of a banking/commercial separation doctrine or another limit like the UK's ring-fencing initiative,

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[51] See, e.g., Australia's proposed APS 222, s. 11(a), which requires arm's length dealings with a potential commercial subsidiary; also § 23A and 23B of the US *Federal Reserve Act*, which require all transactions between banks and their affiliates to be at arm's length.

and given the changing nature of the banking business, regulators will want to ensure that the disclosure / transparency and prudential requirements that apply to banks, and which give them access to special privileges such as LOLR liquidity support and deposit insurance, explicitly account for all the business risks, including non-financial commercial risks, the bank is running.

In consumer protection terms, as well, by comparison to strategies like a comprehensive Consumer Data Right, the banking/commercial separation doctrine is ill-fitting and rigid. It risks both failing to meet its own regulatory purposes, and creating distortions in the market (e.g., because of a non-level playing field between banks and nonbanks). Rather than trying to protect consumers through the proxy of the banking/separation doctrine, it makes sense to address consumer protection, particularly around data, in a direct and explicit fashion.

Concerns about systemic risk and consumer protection have not disappeared; far from it. However, where the will exists to both develop and adequately support more modern regulatory mechanisms, these concerns can now be addressed through potentially more effective means than the banking/commercial separation doctrine.

Appendix 1: Banking Licenses, and the "Business of Banking" Defined

<table>
<tr><th>Jurisdiction</th><th>Definition of banking business</th><th>Licensing body and terms

(bear in mind that licensing bodies may always impose conditions or restrictions on individual banking licenses)</th></tr>
<tr><td>Australia</td><td>Per Banking Act 1959, s. 5, "banking business" means

(a) a business that consists of banking within the meaning of paragraph 51(xiii) of the Constitution [= "banking, other than State banking; also State banking extending beyond the limits of the State concerned, the incorporation of banks, and the issue of paper money"]; or

(b) a business that is carried on by a corporation to which paragraph 51(xx) of the Constitution [= "foreign corporations, and trading or financial corporations formed within the limits of the Commonwealth"] applies and that consists, to any extent, of:

(i) both taking money on deposit (otherwise than as part-payment for identified goods or services) and making advances of money; or

(ii) other financial activities <u>prescribed</u> by the regulations for the purposes of this definition.

- Banking Regulation 2016 is the only relevant regulation, s. 6 of which prescribes that the provision of "purchased payment systems" is banking business effectively if purchaser can demand payment is AUD and system is available on wide basis.</td><td>Banks must be licensed as Authorised Deposit-taking Institution (ADI), through APRA.[52]

Banking Act 1959:

8 Only the Reserve Bank and bodies corporate that are ADIs may carry on banking business

(1) A body corporate commits an offence if:

(a) the body corporate carries on any banking business in Australia; and

(b) the body corporate is not the Reserve Bank; and

(c) the body corporate is not an ADI [Authorised Deposit-taking Institution]; and

(d) there is no determination in force under section 11 that this subsection does not apply to the body corporate [discretionary exemption powers to APRA]</td></tr>
</table>

[52] APRA also licenses *inter alia* building societies, credit unions, insurers under various other licenses, as well as non-operating holding companies (NOHCs) that carry on no other business than owning other bodies corporate. Other financial institutions (broker-dealers and investment advisors, finance companies) can operate under Australian Financial Services (AFS) License granted by ASIC. If engaging in credit activities (e.g., car loans, leases, businesses allowing customers to pay for goods by instalment, issuing mortgages), requires an Australian Credit License (ACL) also granted by ASIC. Full service banks, which also provide investment services etc., require licensing by both APRA and ASIC. *[Broader "provision of financial services" not covered here; more ASIC's concern than APRA's.]*

Jurisdiction	Definition of banking business	**Licensing body and terms** *(bear in mind that licensing bodies may always impose conditions or restrictions on individual banking licenses)*
	- E.g., smart cards, digital assets, travelers cheques	**9 Authority to carry on banking business** (2) A body corporate which desires authority to carry on banking business in Australia may apply in writing to APRA for authority accordingly. Restricted ADI License[53] effective May 2018, with goal to encourage competition while maintaining safety and stability, not disadvantaging incumbents • provides eligible applicants with a restricted licence for a maximum of two years before they must meet the [direct route license] prudential framework in full, so as to enable them to conduct limited banking business while developing their capabilities and resources. If they cannot get there in two years, must wind up. • Principles-based approach with ongoing guidance and support by APRA, taking into account applicant's capabilities, resources, the limitations that will be imposed on size of its business during restricted period, the expectation that applicant engage in lower risk business during restricted period • Lower or simplified capital requirements, liquidity calculations, somewhat relaxed corporate governance and risk governance, risk management requirements – generally early stage business profile • Deposits are not fully protected under Australian Government Financial Claims Scheme (FCS, like CDIC) • Large tech firms are not likely eligible – are too large. Eligibility likely restricted to "new startups" and "small non-ADI SME lenders" (p. 23)

[53] Australian Prudential Regulation Authority, "Information Paper: ADI licensing: Restricted ADI Framework", (Australian Prudential Regulation Authority, 2018) [ARPA, "Restricted ADI Framework"].

Jurisdiction	Definition of banking business	**Licensing body and terms** *(bear in mind that licensing bodies may always impose conditions or restrictions on individual banking licenses)*
		• Restricted license allows licensee to use the word “bank” in name; important signaling device. • Fairly comprehensive disclosure obligations re restricted nature of license, risks As of 20 December 2018, two banks[54] have obtained: volt bank limited and Xinja Bank Limited. volt bank limited became a full, not-restricted ADI in January 2019.
Japan	Banking Act **Article 2**[55] (1) The term "Bank" as used in this Act means a person that engages in Banking under a license from the Prime Minister as referred to in Article 4, paragraph (1). (2) The term "Banking" as used in this Act means the business of performing any of the following activities: (i) acceptance of deposits or Installment Savings, as well as the lending of funds or the discounting of bills and notes; or (ii) dealing in funds transfer transactions. (21) The term "Banking Services" as used in this Act means services that a Bank performs pursuant to the provisions of Article 10 and Article 11 [*discussed below*], services that a Bank performs pursuant to the provisions of the Secured Corporate Bonds Trust Act [N/A] and other laws, and Bank Agency Services that a person engaged in Bank Agency Services performs for a Bank.	Per **Article 4**(1), Prime Minister issues banking licenses. PM delegates responsibility for issuing licenses to the Financial Services Agency of Japan (JFSA). As in the United States Banks/BHCs can establish subsidiaries to engage in broader financial services (i.e., securities trading, broker-dealer services etc.), which requires separate licensing under Financial Instruments and Exchange Act.[56]

[54] Australian Prudential Regulation Authority, “Register of authorised deposit-taking institutions” (2019), online: <www.apra.gov.au/register-authorised-deposit-taking-institutions> [Australian Prudential Regulation Authority, “Register of ADIs”].
[55] Banking Act, Act No 59 of June 1, 1981, as last amended by Act No 49 of 2017 [Japan Banking Act].
[56] Financial Instruments and Exchange Act, Act No 25 of 1948, art 4(1), as last amended by Amendment of Act No 46 of 2017.

Jurisdiction	Definition of banking business	Licensing body and terms *(bear in mind that licensing bodies may always impose conditions or restrictions on individual banking licenses)*
	Article 10 (1) A Bank may perform the following services: (i) acceptance of deposits and Installment Savings, etc.; (ii) the lending of funds and the discounting of bills and notes; and (iii) funds transfer transactions. (2) In addition to the services set forth in the items of the preceding paragraph, a Bank may perform the following services and any other services incidental to Banking: [detailed list of <u>financial</u> activities including guaranteeing obligations, accepting bills and notes, changing money, plus a range of securities-related matters: effecting their purchase and sale, lending securities, acting on a limited range of derivatives transactions specified by Cabinet Order – all of which plausibly fit into "incidental" matters and not actually securities business; definitely not non-financial commercial business. See also Article 33 of Financial Instruments and Exchange Act, which prohibits banks from engaging in securities business subject to, again, a set of detailed exceptions.] **Article 11** In addition to the services it performs pursuant to the provisions of the preceding Article, a Bank may perform the following services, inasmuch as this does not interfere with the performance of the services set forth in the items of Article 10, paragraph (1): [investment advisory work, limited range of securities matters per Article 33 of Financial Instruments and Exchange Act, administering a trust, wrapping up a carbon emissions quota contract]	
Singapore	Section 2 of the Banking Act[57] defines "banking business" as "the business of receiving money on current or deposit account, paying and collecting cheques drawn by or paid in by customers, the	Monetary Authority of Singapore (MAS) issues licenses. MAS seems to be quite hands-on, has tended to make case-by-case decisions on matters under Regulation 23G and generally. Per 23G(6) of the Banking Regulation,[58] "a bank in Singapore that

[57] *Banking Act* (Cap 19, 2008 Rev Ed Sing), s 2 [Singapore *Banking Act*].
[58] *Banking Regulations* (Cap 19, R 5, 2004 Rev Ed Sing), r 23G(6) [Singapore *Banking Regulations*].

Jurisdiction	Definition of banking business	**Licensing body and terms** (*bear in mind that licensing bodies may always impose conditions or restrictions on individual banking licenses)*
	making of advances to customers, and includes such other business as the Authority may prescribe for the purposes of this Act". Banking Act was modified in 2011 by Regulation 23G, which permitted activities that were "related or complementary" to banks' core financial businesses. (Reportedly the provision was not used much; see Appendix 2 for further changes in 2017.)	carries on any business prescribed in paragraph (1) shall comply with such other conditions or restrictions that the Authority [MAS] may impose, from time to time, by notice in writing in relation to its carrying on of such business".
United Kingdom	General description in *FSMA* s. 22: (1) An activity is a regulated activity for the purposes of this Act if it is an activity of a specified kind which is carried on by way of business and— (a) relates to an investment of a specified kind; or (b) in the case of an activity of a kind which is also specified for the purposes of this paragraph, is carried on in relation to property of any kind. Further description is contained in Schedule 2 of the Act and in FSMA (Regulated Activities) Order 2001[59] *(RAO)*. Because the UK has a unified prudential regulator with prudential regulatory jurisdiction over banking, securities and investments, and insurance (as well as benchmarks), Schedule 2 and the RAO include a full range of financial activities including accepting deposits (Chapter	*Financial Services and Markets Act 2000*, s. 19, imposes a general prohibition on carrying on "regulated activities" unless one is an "authorised person". Persons are authorised under *FSMA 2000* Part 4A, "Permission to Carry on Regulated Activities". PRA licenses banks (per s. 55A et seq.)[62] with further "threshold provisions" around, e.g., legal status and location of offices, located in the Act's Schedule 6, Part 1E. PRA and FCA have jointly established "new bank start-up unit"[63] and "new insurer start-up unit"[64] to assist "challenger banks" in navigating the system. Unlike Australia, the UK has not instituted an entry-level or restricted bank/insurer license. However, see list[65] from May 2018 of "challenger banks," virtually all digital with a range of business plans, which are at some stage of applying for banking licenses.

[59] *The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001*, SI, 2001/544.
[62] Full service financial institutions (pursuing "universal banking business model") would also have to register with FCA. *[Broader licensing for "provision of financial services" not covered here; more FCA's concern than PRA's.]*
[63] Bank of England, "New Bank Start-up Unit", (2019), online: <www.bankofengland.co.uk/prudential-regulation/new-bank-start-up-unit>.
[64] Prudential Regulatory Authority and Financial Conduct Authority, "New Insurer Start-up Unit: What you need to know from the PRA and the FCA" (London, 2018).
[65] Tanya Andreasyan, "UK challenger banks: who's who (and what's their tech)" (30 May 2018), *Fintech Futures*, online: <www.bankingtech.com/2018/05/uk-challenger-banks-whos-who-and-whats-their-tech/>.

Jurisdiction	Definition of banking business	**Licensing body and terms** *(bear in mind that licensing bodies may always impose conditions or restrictions on individual banking licenses)*
	2), consumer lending and regulated credit agreements, effecting and carrying out contracts of insurance, multiple investment-related powers incl. dealing as principal or agent, arranging deals, managing investments, advising; also specific kinds of financial products such as mortgages, funeral plan contracts. PRA Rulebook Glossary[60] does not define banking but it **defines "bank"** to mean: (1) a firm with a Part 4A Permission to carry on the regulated activity of accepting deposits and is a credit institution, but is not a credit union, friendly society or a building society; or (2) an EEA bank. To be regulated, activities must be carried on in connection with "specified investments" incl deposits, e-money, insurance, shares and derivatives, generally other financial assets. (Suggests that some commercial business is not "regulated activity" even when undertaken by "authorised person." However, once a firm is an authorised person, the FCA can make rules governing unregulated activity by that authorised person or by authorised persons in general: FCA, 30 Jan 2018.)[61]	
United States (federal)	Per the *Bank Holding Company* (BHC) Act: companies that control banks can only engage in the activities of managing or controlling banks unless an exception from the "nonbanking prohibitions" of the BHC Act applies. The exceptions permit activities that are	Office of the Comptroller of the Currency (OCC), an independent bureau within Treasury, is primary national bank regulator/supervisor.

[60] Prudential Regulatory Authority, "PRA Rulebook: Glossary", (2015), online: <www.prarulebook.co.uk/rulebook/Glossary/Rulebook/0/03-09-2015/B>.
[61] Letter from Andrew Bailey, Chief Executive of the Financial Conduct Authority to Rt Hon Nicky Morgan MP (30 January 2018), online: Financial Conduct Authority <www.parliament.uk/documents/commons-committees/treasury/Correspondence/2017-19/FCA-powers-perimeter-300118.pdf>.

Jurisdiction	Definition of banking business	**Licensing body and terms** *(bear in mind that licensing bodies may always impose conditions or restrictions on individual banking licenses)*
	"closely related to banking", and certain passive and non-controlling investments.[66] Definitions: "bank" = (1) Except as provided in paragraph (2) [exceptions for foreign banks, some state-level savings institutions, institutions that function solely in a trust or fiduciary capacity and that effectively do not engage in depository banking], the term "bank" means any of the following: (A) An insured bank as defined [by the FDIC], (B) An institution organized under the laws of the United States, any State of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands which both— (i) accepts demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others; and (ii) is engaged in the business of making commercial loans.	Has established a Responsible Innovation Office,[69] which has developed "special purpose national bank charters"[70] for fintech firms (considering applications from 31 July 2018), Per the press release: • "The OCC will consider applications from fintech companies to charter a special purpose national bank that would engage in one or more of the "core banking activities" of paying checks or lending money but would not take deposits and would not be insured by the FDIC. The OCC stated that a qualified fintech company that receives a special purpose national bank charter will be subject to the same high standards of safety and soundness and fairness that all federally chartered banks must meet, and will be supervised like similarly situated national banks, including with respect to capital, liquidity, and risk management. … • Fintech companies that apply and qualify for, and receive, special purpose national bank charters will be supervised like similarly situated national banks, to include capital, liquidity, and financial inclusion commitments as appropriate [among other requirements] … New fintech

[66] Broader category of Financial Holding Company, FHC, subject to higher management and capital requirements, is full service institution with insurance and securities and "merchant banking" capacities It is not a bank or a bank holding company. FHCs could get case-by-case approval to engage in "complementary" activities, had a grandfathered ability to engage in commodity trading, and had the ability, through their merchant banking arms, to invest in virtually any non-financial interest. For a comprehensive review, see Saule T. Omarova, "The Merchants of Wall Street: Banking, Commerce, and Commodities" (2013) 98:1 Minn L Rev 265. In September 2016, a joint report to Congress and the FSOC prepared by the Federal Reserve, the OCC, and the FDIC advised Congress to repeal FHCs' ability to engage in merchant banking activities, and to significantly limit their ability to engage in grandfathered and "complementary" activities. The report is unlikely to produce results during the current US presidential administration. In any event, merchant banking is distinct from "banking" as discussed in this report. (Office of the Comptroller of the Currency et. Al., Report to the Congress and the Financial Stability Oversight Council Pursuant to Section 620 of the Dodd-Frank Act (Washington: 2016).

[69] Office of the Comptroller of the Currency, "Responsible Innovation", online: <www.occ.gov/topics/responsible-innovation/index-innovation.html>.

[70] Office of the Comptroller of the Currency, News Release, "OCC Begins Accepting National Bank Charter Applications from Financial Technology Companies" (31 July 2016), online: <www.fdic.gov/news/news/press/2016/pr16027.html>.

Jurisdiction	Definition of banking business	Licensing body and terms *(bear in mind that licensing bodies may always impose conditions or restrictions on individual banking licenses)*
	A **Bank Holding Company** may also engage directly in, or establish or acquire subsidiaries that engage in, nonbanking activities determined by the Federal Reserve Board to be closely related to banking (e.g., mortgage banking, consumer and commercial finance and loan servicing, leasing, collection agency, asset management, trust company, real estate appraisal, financial and investment advisory activities, management consulting, employee benefits consulting, career counseling services, and certain insurance-related activities). See Federal Reserve Manual at §3000 et seq., nonbank activities.[67] A **Bank** (meaning not its holding company), per OCC, may engage in activities that are "incidental to banking", initially published by way of No-Action Letters and compiled into Comptroller's Licensing Manual[68] (2017). Permits banks to *have subsidiaries* engaging in businesses that provide services incidental to their banking business: incl. holding assets, offering internal day-to-day operational services to the bank, lending and credit activities, management consulting advice for *other banks*, providing fairly extensive range of data-processing, data warehousing and data transmission products, services, and related activities and facilities, including associated equipment and technology" for the bank itself (pp. 36-37), plus securities-related activities (underwriting, investment advising, broker-dealer services etc.), acting as a website host (p. 55), provide or sell electronic data- processing and data-transmission services, databases, and facilities (p. 61); acting "as a digital certification authority", issuing digital certificates and acting as a repository of public keys and certificate information.. … may also provide connected data-processing services and may sell or rent equipment, … provide consulting or advisory services to help customers, including other banks, to implement digital	companies that become special purpose national banks will be subject to heightened supervision initially, similar to other de novo banks. --- **Industrial Loan Companies (ILCs) and Innovation at the Federal Depository Insurance Corporation (FDIC)**: FDIC is concurrent regulator for national banks (in regard to depository insurance), primary federal regulator for state banks (whose deposits they also insure). Virtually all commercial banks in US must be insured by FDIC • July 2018 announcement re FDIC setting up an "office of innovation" to encourage banks to adopt fintech strategies (with eye to helping smaller banks with fewer resources remain competitive) • Per Chair McWilliams, October 2018,[71] "FDIC could encourage innovation in three ways: The first is through the industrial loan company, a specialized banking charter supervised by the FDIC; the second way would be through the FDIC's regulation of banks' third-party vendor relationships; and the third is by working with tech companies to obtain improved processing, service and efficiency at banks" • Industrial Loan Companies (ILCs):

[67] United States, Federal Reserve, *Bank Holding Company Supervision Manual*, (Washington: 2017) at s 3000.
[68] United States, Office of the Comptroller of the Currency, *Controller's Licensing Manual: Subsidiaries and Equity Investments*, (Washington: 2019).
[71] Neil Haggerty, "FDIC to launch innovation office to help banks compete with fintechs", *American Banker* (23 October 2018), online: <www.americanbanker.com/news/fdic-to-launch-innovation-office-to-help-banks-compete-with-fintechs>.

Jurisdiction	Definition of banking business	**Licensing body and terms** (*bear in mind that licensing bodies may always impose conditions or restrictions on individual banking licenses)*
	signature systems." Banks can also ***own non-controlling equity stakes*** in loan, lease, reporting, and credit-related businesses including credit cards, payment services, data processing and correspondent services (pp. 66-67), real estate, insurance, securities	○ Controversial: a bank charter that allows companies to own a bank w/o having to comply with *Bank Holding Company Act* requirements. ○ Deposits insured by FDIC. ○ Available in 9 states, with Utah being dominant ○ Apparently of interest to fintechs that want to offer fuller range of services including taking deposits: student online lender SoFi[72] applied then withdrew application, 2017; Square applied then withdrew, but claims continued intention to become ILC

[72] Ainsley Harris, "Are you ready to ditch your bank? SoFi is betting its future on it", *Fast Company* (19 June 2018), online: <www.fastcompany.com/40585328/are-you-ready-to-ditch-your-bank-sofi-is-betting-its-future-on-it> [Harris, "Are you ready to ditch your bank?"].

Appendix 2: The banking/commercial separation doctrine and caps on non-financial ownership

Jurisdiction	Caps on non-financial ownership?	Formal banking/commercial separation doctrine?
Japan	Yes 2016 Banking Act amendments (in effect April 1, 2017): Under Banking Act Article 16-4, banks could formerly not hold more than 5% voting rights in any non-financial company; for BHCs the limit was 15%. Limits are now lifted, again subject to JFSA approval, for new kinds of subsidiaries as described in Banking Act Article 16-2(xii, xii-2, xii-3)[73]	Yes Banking Act[74] **Article 12** A Bank may not do business other than that which it does pursuant to the provisions of the preceding two Articles and that which it does pursuant to the provisions of the Secured Bonds Trust Act [N/A here] or other laws.
Singapore	Yes Per 2017 Consultation Paper on the Anti-Commingling Policy,[75] s. 3.2, dealing with permissible non-financial businesses under regulation 23G, the "aggregate size of all businesses carried on by the bank under regulation 23G [must] not exceed 10% of the bank's capital funds (solo and group)" For any other businesses a bank acquires, which are not permissible non-financial businesses under regulation 23G, • s. 31 of the Banking Act prescribes a single equity investment limit of 2% of the bank's capital funds. • s. 32 of the Banking Act requires MAS approval for acquisition of a major (<10%) stake in an entity.	Yes but softening An "anti-commingling policy" separating financial and non-financial businesses of banks in Singapore was established in 2001. It was modified in 2011 by Regulation 23G, which permitted activities that were "related or complementary" to their core financial businesses. Regulation 23G reportedly not used much; new 2017 Consultation Paper has clarified and "streamlined" provisions, seemingly with changing technology and the changing nature of banking in mind, including "matching buyers and sellers of consumer goods". *2011 Regulation 23G and 2017 Consultation Paper described below*

[73] (xii) a company specified by Cabinet Office Order as one that is developing a new business field [additional detail here]
(xii)-2 a company that performs new business activities that are found to contribute considerably to the improvement of management [additional detail];
(xii)-3 beyond what is set forth in the preceding items, a company that performs services that contribute or are expected to contribute to the advanced Banking conducted by the Bank or the enhanced convenience of users of the Bank by utilizing technology including information and telecommunication technology;

[74] Japan Banking Act, *supra* note 37 at art 12.

[75] Singapore, Monetary Authority of Singapore, *Review of Anti-Commingling Framework for Banks* (Monetary Authority of Singapore, 2017) at para 2.1 [Monetary Authority of Singapore, "Anti-Commingling"].

Jurisdiction	Caps on non-financial ownership?	Formal banking/commercial separation doctrine?
United States (federal, for bank holding companies)	Yes BHCs can make investments in companies not engaged in activities closely related to banking, but these investments cannot exceed 5 percent of the target company's outstanding voting stock.[76]	Yes: see Appendix 1
Australia	No, however must give notice to APRA of intentions beyond threshold of 20% in acquisition / 10% of exposure Per **APRA's current 2015 APS 222**, *Associations with Related Entities*, para 31, ADIs "must consult with APRA before: … committing to any proposal to acquire (whether directly or indirectly) more than 20 per cent of equity interest in an entity" **Proposed APS 222** (which may come into force January 1, 2020), para 37: An ADI must notify APRA prior to: … (b) committing to any proposal to acquire (whether directly or indirectly) more than 20 per cent of equity interest in an entity; and (c) committing to any proposed exposure to a related entity that is greater than, or equal to, 10 per cent of the ADI's Tier 1 Capital.	No (twin peaks regime)
United Kingdom	No EU Directive 2006/48/EC Article 120 imposes a 15% ownership cap for own funds, but this provision was not transposed into UK law.[77]	No (twin peaks regime)

[76] Federal Reserve System, "Bank Holding Companies and Financial Holding Companies", online: Partnership for Progress <www.fedpartnership.gov/bank-life-cycle/grow-shareholder-value/bank-holding-companies>
[77] United Kingdom, *Implementing amendments to the Capital Requirements Directive* (HM Treasury, 2010).

Appendix 3: High-level review of select legislative and regulatory changes

Australia

Australia, like Canada, has a concentrated banking sector. Its banking market is largely controlled by four major banks: National Australia Bank (NAB); Commonwealth Bank (CBA); Australia and New Zealand Banking Group (ANZ); Westpac (WBC). Recent scandals have badly undermined the credibility of Australia's market conduct and consumer protection regulator, the Australian Securities and Investments Commission (ASIC). Australia's prudential regulator, the Australian Prudential Regulatory Authority (APRA), was not directly implicated. Nevertheless, the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry[78] produced a scathing report on misconduct in the banking, investment, insurance, and superannuation markets. Its final report was made public in February 2019. Among other things, it identified a lack of competition within financial markets, combined with regulatory laxity, as contributing factors.

Australia's Productivity Commission, analogous to our Competition Bureau, issued a strongly worded critique in its Inquiry Report on Competition in Australian Financial System[79] (June 2018). The Commission took note of Australian large banks' and insurers' market power and the concentration of the industry, and criticized opaque pricing practices, poor advice, regulatory shortcomings, and poor consumer outcomes. It recommended that Australia take explicit steps to promote greater competition. Based on a series of detailed examinations into the structures on which the banking business relies, it saw limited evidence that, in the absence of regulatory change, foreign banks, fintechs, or large tech companies were actually in a position to offset banks' current market power.

Australia
Banking Licenses: Restricted ADI License[80] (as with proposed US OCC restricted license) effective May 2018, with goal to encourage competition while maintaining safety and stability, not disadvantaging incumbents • provides eligible applicants with a restricted licence for a maximum of two years before they must meet the [direct route license] prudential framework in full, so as to enable them to conduct limited banking business while developing their capabilities and resources. If they cannot get there in two years, must wind up. • Principles-based approach with ongoing guidance and support, taking into account applicant's capabilities, resources, the limitations that will be imposed on size of its business during restricted period, the expectation that applicant engage in lower risk business during restricted period

[78] Australia, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report* (Canberra: 2019).
[79] Australia, Productivity Commission, *Productivity Commission, Competition in the Australian Financial System, Inquiry Report* (Canberra: 2018).
[80] ARPA, "Restricted ADI Framework", *supra* note 35.

Australia
○ APRA provides ongoing guidance incl early contact in pre-application stage, several meetings (incl. with IT specialists if needed) to develop application ○ Lower or simplified capital requirements, liquidity calculations, somewhat relaxed corporate governance and risk governance, risk management requirements – generally early stage business profile • Deposits are not fully protected under Australian Government Financial Claims Scheme (FCS, like CDIC) • Large tech firms are not likely eligible – are too large. Eligibility likely restricted to "new startups" and "small non-ADI SME lenders" (p. 23) • Restricted license allows licensee to use the word "bank" in name; important signaling device. • Fairly comprehensive disclosure obligations re restricted nature of license, risks • As of 20 December 2018, two banks[81] have obtained: volt bank limited and Xinja Bank Limited. volt bank limited became a full, unrestricted ADI in January 2019.
Proposed APS 222 (coming into force January 1, 2020): • *See discussion in main body of report*: unclear whether consolidation, prudential, and reporting requirements would cover all "related entities", including those that are not counterparties
Payment Systems (includes ATM system, credit card debit systems (Visa and MC), Paypal): primary oversight and regulation of payments system falls under the Reserve Board of Australia's jurisdiction but need ADI license from APRA to engage in "banking business"[82]. Purchased payment facility, as part of banking business, must comply with prudential requirements (minimal capital adequacy, liquidity and asset requirements) and have in place systems to manage operational risk. As of 20 Dec 2018 (see link above), PayPal is only standalone licensed provider of purchased payment facilities
Amendments[83] to *Financial Sector (Shareholdings) Act 1998* (the *FSSA*), passed and assented to 29 Nov 2018: • increasing from 15% to 20% the ownership limit that can be sought in a financial sector company without having to seek approval from the Treasurer; and

[81] Australian Prudential Regulation Authority, "Register of ADIs", *supra* note 36.
[82] Overview of structure as of 2011 from BIS. (Bank for International Settlement, *Payment, clearing and settlement systems in Australia*, (Committee on Payments and Market Infrastructure, 2011).
[83] Treasury Laws Amendment (Financial Sector Regulation) Bill 2018 (Cth).

Australia
• a new streamlined FSSA approval path for owners to hold (or invest) more than 20% in a new or recently established financial sector company provided the investors meet a “fit and proper” test and comply with asset requirements and ongoing conditions.
Partnerships with fintech companies, or fintech investments by “big four” banks, seem extensive (per KPMG,[84] Westpac Wire,[85] NAB,[86] CommBank,[87] ANZ[88]) • links do not present comprehensive overview – investments seem to go into tens and even hundreds of millions (direct investment or lines of credit for fintech startups, sometimes in concert with other banks such as ING)
Open Banking initiative • phased in from July 2019, based on Consumer Data Right as recommended by Productivity Commission in 2017. Banking is first sector subject to CDR, with telecom and energy likely to follow next • “The CDR gives Australians the right to move their data around, making it easier to access your data – such as the financial information your bank has on you – and share this with other businesses. This open data environment is expected to ramp up competition and allow consumers to negotiate better deals and save money” per Choice,[89] consumer advocacy group • Removes banks’ informational advantage relative to fintechs, e.g., allowing fintechs to offer lower interest rate credit cards, P2P lending platforms, SME short term loans • Customers must provide explicit consent for sharing data, can direct banks to share data with anyone incl. competitors. • Risk mitigating initiatives being introduced include creation of new Data Standards Body to set standards for transfer, security, data; Accreditation requirement on entities that receive and send data; fact that data must be shared through an API, “championed by experts as the most efficient and secure way to share data with third parties”

[84] Elizabeth Barry, “KPMG: Australian banks leading on fintech innovation”, (2017), online: <www.finder.com.au/kpmg-australian-banks-leading-fintech-innovation>.
[85] Guy Thursby, “Let’s do lunch: fintechs, banks and future,” (2018), online: <www.westpac.com.au/news/in-depth/2018/06/lets-do-lunch-fintechs-banks-and-future/>.
[86] James Eyers & Clancy Yeates, “NAB Ventures created to invest $50m in fintech”, (2015), online: <www.afr.com/markets/nab-ventures-created-to-invest-50m-in-fintech-20150729-gin0tg>.
[87] Commonwealth Bank of Australia, “Our Innovation Labs”, (2019), online: <www.commbank.com.au/about-us/innovation-lab.html>.
[88] Brenda Chai, “ANZ Joins Digital Trade Distribution Platform, Ccrmanager”, (2018), online: Australia and New Zealand Banking Group < institutional.anz.com/insight-and-research/ANZ-joins-digital-trade-distribution-platform-CCRManager>.
[89] Nigel Bowen, ‘Open banking is coming, and it could save you money,’ (2018), online: choice <www.choice.com.au/money/banking/everyday-banking/articles/open-banking-to-give-consumers-control-of-their-data>.

Australia
• Implementation phased in by product and nature of entity (“big four” banks going first) between July 2019 and July 2021.
Wholesale payments, settlement, clearing regime New Payments Platform[90] and fast settlement service. Per Productivity Commission 2018 report @29-30: “The New Payments Platform (NPP) requires an access regime. … The NPP, which became operational in early 2018, is set to replace the current technology through which over $1 trillion moves between banks each month. It was set up, and is mutually owned, by 13 initial shareholder participants (including the major banks and the RBA). Regulators should act now to facilitate fair access to the NPP in its early days — which will likely determine whether the platform will become a hotbed for innovation and competition, or yet another payment system subject to the market power of incumbents. “The NPP is expected to reduce technical barriers for new financial institutions to enter the payments system, and enable existing institutions to provide more efficient services through real time transfers of funds. It provides a rich set of payment data, which could be used by fintechs and incumbents alike to develop new applications. … the RBA should establish a formal access regime for the NPP.

[90] Reserve Bank of Australia, “The New Payments Platform”, online: <www.rba.gov.au/payments-and-infrastructure/new-payments-platform/about-npp.html>.

Japan

Japan has made decisive moves to allow banks to engage in fintech, and there is evidence that it is considering a move toward more cross-sectorial, purpose-oriented regulation; i.e., to move away from the entity-based regulatory regime that exists in Canada and the US. Japan has made clear moves to allow banks to engage in a broader range of services, including crowdfunding and creating digital currencies, etc. These activities are still pretty much entirely within the scope of "financial activities," however, and do not stray into purely "commercial" businesses.[91] The FSB's peer review of Japan,[92] in 2016, identified some concerns around macroprudential regulation and inter-agency coordination.

Japan
2016 Banking Act Amendments (in force 1 April 2017) • heightened risk management, governance, and disclosure obligations on bank holding companies or parent banks *in regard to all subsidiaries and components* • new ability to aggregate operational services across group – e.g., beyond just managing subs, BHC can now develop systems, negotiate leases, conduct R&D and wholesale product development, etc. for all companies within the BHC (at least one of which must be a "bank") • *relaxation of income dependency provisions*: subs engaged in "Ancillary Business" no longer need to earn 50% of revenues from within the BHC ["Ancillary" very similar list to "incidental" business under Banking Act Article 10(2), described above under definition of "banking"] • relaxation of arm's length rule: companies within a banking group can transact with each other not at arm's length, subject to disclosure obligations, JFSA approval, and so long as transaction is not likely to affect banking group's soundness • *new fintech investment scope*: Per Banking Act Article 16-4, banks could formerly not hold more than 5% voting rights in any non-financial company; for BHCs the limit was 15%. Limits are now lifted, again subject to JFSA approval, for new kinds of subsidiaries as described in Banking Act Article 16-2(xii, xii-2, xii-3)[93] • foreign banks can now obtain group-wide, not individual sub-level, permission for bank agency and intermediary services

[91] One potential exception may be the intention of Japan's largest bank, MUFG, to leverage its real estate business, which until now had been separately operated and which has a real estate broker's license. Its Annual Report 2018 at p. 16 may suggest that it is contemplating some beyond-finance activities in the areas of "property appraisals, tenant leasing, custody, asset management and brokerage, and property management." (Mitsubishi UFJ Financial Group, "MUFG Report 2018 (JGAAP)", (Japan: 2018))

[92] Financial Stability Board, *Peer Review of Japan* (Financial Stability Board, 2016).

[93] (xii) a company specified by Cabinet Office Order as one that is developing a new business field [additional detail here if needed]
(xii)-2 a company that performs new business activities that are found to contribute considerably to the improvement of management [additional detail];
(xii)-3 beyond what is set forth in the preceding items, a company that performs services that contribute or are expected to contribute to the advanced Banking conducted by the Bank or the enhanced convenience of users of the Bank by utilizing technology including information and telecommunication technology;

Japan
2017 Banking Act Amendments (beginning to come into force June 2018, with grace period for some provisions) aimed at "promoting appropriate cooperation and collaboration between financial institutions and finance-related IT companies as well as to ensure user protection, in response to rapid IT development and its impact on financial services."[94] ***Note***: according to this[95], "Japan's current banking laws do not let the financial institutions themselves take part in such operations as digital payments and e-commerce"; therefore presumably they must partner with PSPs Provisions for open API and Electronic Service Provider regulation, seem equivalent to PSD2 in EU • Electronic service providers[96] must now be registered, undertake disclosure (subject to some exemptions where risks to service users considered lower)[97]. Must enter into contract with banks to provide payment services, including risk management provisions • Banks must establish standards for contracts with payment services providers (around e.g., risk); cannot discriminate against non-bank PSPs • Banks that want to work with PSPs must make efforts to develop Open API platform within two years of amendments
New JFSA Policy document June 2018 interim discussion paper [no concrete outcomes yet, unclear if/how this will proceed) on **move away from entity-based regulatory framework** toward more "function-based, cross-sectoral" regulation "in light of unbundling and rebundling … to apply the same rules to activities with the same functions and risks"

94 Financial Services Agency, Press Release, "FAQ of the Fintech Support Desk of FSA: Open API and Electronic Payment Services", (14 December 2015), online: <www.fsa.go.jp/en/news/2018/20180717.html>.

95 Nikkei Asian Review, "Japan looks to jump-start fintech with legal overhaul", (October 13, 2017), online: <asia.nikkei.com/Business/Banking-Finance/Japan-looks-to-jump-start-fintech-with-legal-overhaul>.

96 An "electronic payment service" means the services utilizing IT such as:

(i) A service that enables money transfers to multiple accounts per request with one click; and

(ii) A service that automatically creates and keeps a household account book by obtaining and aggregating account information including account balance and transaction records from banks

[aka "EDIs", electronic data interchange, or "TPPs", third party providers, or e-commerce – mechanisms such as credit cards, Paypal, Apple Pay, mobile money wallets, etc. for making payments online]

97 (1) Transmission of settlement instructions conducted for the purpose of making periodical payments from a depositor to a particular person

(2) Transmission of settlement instructions conducted for the purpose of money transfer from a depositor to the depositor' own account

(3) Transmission of settlement instructions conducted for the purpose of making payments from a depositor to the national and local governments

(4) Transmission of settlement instructions conducted by (i) a depositor's counterparty to sales contracts on goods and services or (ii) the counterparty's agent, for the purpose of making payments for the sales contracts

Japan
(Summary document[98] available in English, of Interim Note by the Study Group on the Financial System under the Financial System Council, Japan. Underlying report available in Japanese only). Notes, *inter alia*, "4 Approach to entity-based regulations (i.e. regulations on scope of permissible business, safety nets, etc.) under the function-based, cross-sectoral financial regulations - Amid blurring boundaries between financial services and non-financial services, banks and banking groups are subject to strict entity-based regulations (i.e. regulations on scope of permissible business, prudential regulations, safety nets, etc.) • There is room to reconsider the focus placed on regulations on scope of permissible business of banks and banking groups • Regulations on scope of permissible business should be reviewed so that groups with the top-tier company being bank holding companies (i.e. value of shares of subsidiaries accounts for more than 50% of total assets), banks, and other business companies can compete on an equal footing basis, with attention to the differences in the effectiveness of avoiding risk in other business to the basic lines of business of banks • Considering possible changes in the scope of business that conventional banking groups are expected to engage in, broad-ranging studies will be necessary to update prudential regulations which accommodate risks of new types of business • It will be necessary to consider whether objectives and coverage of safety nets may change, and effective methods will need to be considered accordingly "5 Approach to rules for the process of providing products and services - Harmonization of rules for the process of providing products / services such as intermediary and agency services will be important so as not to hinder the cross-sector, cross-function provision of products / services which meets user needs - Considering possible changes in the structure of financial networks, it will be important to consider appropriate rules for platform providers (those that match parties to contracts in financial transactions), rather than regulating platform users (parties to the contracts), for effective implementation"

[98] Financial Services Agency, *Summary of the Interim Note by the Study Group on the Financial System under the Financial System Council, Japan* (Tokyo: 2018).

Singapore

Singapore is taking steps to become a fintech hub not only in banking but in finance generally. Singapore's unified financial regulator, the Monetary Authority of Singapore (MAS), has permitted banks to engage in business lines that are "adjacent" to its core businesses since 2011, when it promulgated its Regulation 23G. In 2017, it provided further guidance in an "Anti-Commingling Consultation Paper," discussed below, which would expand the scope of activities that banks can engage in. A high level of government control over the economy in Singapore perhaps explains certain idiosyncrasies (e.g., the prohibition on banks engaging in property development work – in Singapore, 70% of residential properties belong to public housing program). Notably, as well, the FSB's 2018 peer report identifies concerns around systemic risk in relation to Singapore's commitment to fostering fintech in its jurisdiction.

Singapore
2011 Regulation 23G The pre-existing 2001 "anti-commingling policy" was intended to help banks remain focused on their core banking business and competencies, and avoid potential contagion from the conduct of non-financial businesses. The general thrust was to prohibit banks from: (a) directly undertaking businesses other than banking business and financial businesses[99]; (b) acquiring major stakes in companies engaging in non-financial businesses[100]; and (c) using or sharing their names, logos or trademarks on or with (i) physical infrastructure; (ii) sponsored events; or (iii) any non-financial affiliate[101]. (Para 2.1 of the 2017 Consultation Paper[102]) *Regulation 23G*: In 2011, regulation 23G[103] of the Banking Regulations was introduced, giving banks flexibility to carry on businesses that are related or complementary to their core financial businesses. (para 2.2 of the 2017 Consultation Paper[104])

[99] Singapore *Banking Act, supra* note 39 at s 30.
[100] Ibid at s 32.
[101] Ibid at s 5A.
[102] Monetary Authority of Singapore, "Anti-Commingling*", supra* note 75.
[103] Singapore *Banking Regulations, supra* note 40 at r 23G.
[104] Monetary Authority of Singapore, "Anti-Commingling*", supra* note 75 at para 2.2.

Singapore
○ allows banks to carry on businesses "that are related or complementary to the bank's core financial business but which may not be clearly financial," without the need for prior prescription by class or specific approval on a case-by-case basis by MAS, subject to certain conditions, limits and requirements. (para 2.1 of 23G and 7A Guideline[105]) ○ Clearly non-financial businesses continue to be prohibited. (para 1.4 of the 2010 Consultation Paper[106]) "Regulation [now 23G, formerly 23F] widens the permissible businesses beyond those that are strictly financial and incidental to financial and allow businesses which are more broadly related or complementary to the core financial business of the bank. These businesses should *support* the bank's financial businesses and should *not be unrelated* to the core financial business of the bank. … – the bank has to *show a connection* between the businesses and the core financial business of the bank. … Whether a business is considered related or complementary to the core financial business of a bank *depends in part on the business model of the bank*." (2010 Consultation Paper[107] at p. 12, my emphasis) Other conditions: • *Inter alia,* "the businesses must already be carried on by a regulated financial institution in any jurisdiction, and permitted under the laws of that jurisdiction and by the supervisory authority of the financial institution. The businesses also have to be allowed by the parent supervisory authority of the bank, under the laws of the home jurisdiction of the bank. (para 2.4 of 23G and 7A Guideline[108]) • Must obtain prior approval from their parent supervisory authorities – *proposed to be revised, below* • [also engage external auditors, stress tests, reporting requirements to MAS, other governance] • some businesses such as property development, provision of hotel and resort facilities, and sale of consumer goods, are strictly prohibited (regulation 23G(1)(e).[109] (para 2.2 of the 2017 Consultation Paper[110])
2017 Anti-Commingling Consultation Paper ***[seems more like a policy paper and includes specific guidance; no apparent follow-up or formal changes to Regulation 23G are yet publicly available]*** June 2017, MAS announced intention to refine the anti-commingling framework for banks in two key aspects:

[105] Singapore, Monetary Authority of Singapore, *Guidelines on Banking Regulations 23G and 7A* (Monetary Authority of Singapore, 2011) at para 2.1 [Monetary Authority of Singapore, "23G and 7A Guidelines"].
[106] Singapore, Monetary Authority of Singapore, *Proposed Regulations to Allow Businesses Related or Complementary to Core Financial Business* (Monetary Authority of Singapore, 2010) at para 1.4.
[107] Ibid at 12.
[108] Monetary Authority of Singapore, "23G and 7A Guidelines", *supra* note 86 at para 2.4.
[109] Singapore *Banking Regulations, supra* note 40 at r 23G(1)(e).
[110] Monetary Authority of Singapore, "23G and 7A Guidelines", *supra* note 86 at para 2.2.

Singapore
(a) The conditions and requirements under regulation 23G will be streamlined so as to make it easier for banks to conduct or invest in permissible non-financial businesses that are related or complementary to their core financial businesses; (for full discussion, see response to the question regarding supervision below) and (b) Banks will be allowed to engage in the operation of digital platforms that match buyers and sellers of consumer goods or services, as well as the online sale of such goods or services. (para 2.5 of the 2017 Consultation Paper[111]) Two main revisions planned to the list of prohibited non-financial businesses outlined in the current Regulation 23G(1)(e) (para 4.2): a) Banks will no longer be strictly prohibited from carrying on the business of selling consumer goods (currently prohibited by 23G(1)(e)(ii)) b) Banks will only be allowed to engage in property management for properties held by the bank or an entity in its banking group. (i.e. its subsidiary or any other entity treated as part of the bank's group for accounting purposes according to the Accounting Standards) (relating to the current provision of 23G(1)(e)(iv)) To "enable banks to compete effectively against the non-financial players in the new digital economy," MAS proposes to allow banks to engage, directly or indirectly, in the following businesses, under regulation 23G (para 4.4): (a) Operation of online location or electronic platform that matches buyers and sellers of consumer goods or services; (b) Sale of consumer goods or services via online location or electronic platforms; and (c) Any business which is incidental to the business set out in paragraph (a) or (b) above e.g. the provision of logistics services to deliver the goods to consumers. The exact language of proposed provisions is in Annex E, F and G of the 2017 Consultation Paper[112] at pp. 25-37. Following MAS' announcement on the streamlined anti-commingling framework, some banks have also provided feedback that they would like to be able to conduct or invest in certain businesses, "as part of their strategy to provide integrated solutions to their customers". MAS has said that it is prepared to allow banks to conduct these activities, so long as conditions under revised Regulation 23G are complied with (para 4.7-4.8 of the 2017 Consultation Paper[113]): (a) sale of software or systems that were originally developed or commissioned by the bank for its core financial business (e.g. sale of accounting or risk analytics software); and (b) entering into tie-ups or referral arrangements with any person for that person to sell or provide the person's products or services which that person will be solely responsible for delivering or performing.

[111] Ibid. at para 2.5.
[112] Ibid. at 25-37.
[113] Ibid. at paras 4.7-4.8.

Singapore
Another important measurement is the aggregate size of a bank's non-financial business. MAS proposes to set the condition that the aggregate size of all businesses carried on by the bank under regulation 23G does not exceed 10% of the bank's capital funds (solo and group). (para 3.2 of the 2017 Consultation Paper[114]) [more detail on calculating aggregate size in the Consultation paper] Reporting changes: under 2011 Regulation 23G, quarterly and annual reports were required. Under proposed 2017 provisions, only quarterly reports required (pp. 21-23), disclosure of balance sheet, revenue numbers, and exposure of all businesses that would fall under new Regulation 23G [more detail available if needed]. Also must give MAS advance notice of intention to conduct new business, not provide indemnities, engage in appropriate risk management, more. However, • MAS proposes to *remove the requirement for banks to seek prior parent supervisory approval*. (emphasis mine) (For the avoidance of doubt, a foreign bank should still seek its parent supervisory authority's approval if this is a requirement imposed on the bank in its home jurisdiction.) (para 3.2) Still room for case-by-case review. Any businesses that do not fall within above limits require advance MAS approval, because "banks should not be engaging in the sale of goods or non-financial services as a business in its own right" (para 4.9)

[114] Ibid. at para 3.2.

Taiwan

Taiwan's banking industry is unlike the others considered here. It has an "under-concentrated" banking sector, characterized by excessive competition, low profit levels, no economies of scale, and reportedly long-term unsustainability in financial positions.[115] Some of Taiwan's largest domestic banks are still state-owned banks, which survived privatization efforts in the 1980s and 1990s. No domestic bank has more than 10% market share. In response, Taiwan has made efforts to promote mergers and to reach out to other potential depositors internationally. At least on paper, its integrated financial regulator, the Financial Supervisory Authority, seems to have substantial oversight powers. Taiwan's first experiment under its new *Experimentation Act*, below, is interesting: it is a joint effort between a bank and a telecom to offer loan and credit card lines based on credit scores, derived from customers' payment of telecom fees.

<table>
<tr><th>Taiwan</th></tr>
<tr><td>
Experimentation Act:
Financial Technology Development and Innovative Experimentation Act (2018)
Article 1: This Act is enacted for the purpose of creating a safe environment for experimentation involving innovative financial technologies (referred to as "innovative experimentation" hereunder) to develop technology-based innovative financial products or services, facilitate the development of inclusive financial systems and financial technologies, and put into effect the protection of innovative experimentation participants (referred to as the "participants" hereunder) and financial consumers.
Article 3: "innovative experimentation" is "utilizing technological innovation or business model innovation to undertake experimentation of financial businesses [term not defined] that requires the permission, approval or concession of the competent authority".
Article 7: To promote the innovation and development of financial technology and to uphold public interest, the competent authority should, when reviewing an innovative experimentation application, consider the following based on the scope, duration and scale of the proposed innovative experimentation:
1. Whether the experimentation involves financial businesses that require the permission, approval or concession of the competent authority;
2. Whether the experimentation is innovative;
3. Whether the experimentation can effectively increase the efficiency of financial services, reduce operational and use costs or enhance the interests of financial consumers and enterprises;
4. Whether potential risks have been assessed and relevant response measures prepared;
5. Whether participant protection measures have been established and appropriate compensation prepared; and
6. Other matters that should be evaluated.
Article 9: The period of innovative experimentation approved by the competent authority shall be limited to one year [with opportunity to apply for extension].
</td></tr>
</table>

[115] As of April 2018, Taiwan had 38 domestic banks (with 3,411 branch offices), 29 local branches of foreign and mainland China banks, 23 credit cooperatives, 283 farmers' credit unions, and 28 fishermen's credit unions: Export.gov, International Trade Administration, U.S. Department of Commerce, at https://www.export.gov/article?id=Taiwan-Banking-Systems.

Taiwan
Article 17: Where an innovative experimentation is inventive, effectively increase the efficiency of financial services, reduce operational and use costs or enhance the interests of financial consumers and enterprises, the competent authority should take the following actions in consideration of the implementation status of the innovative experimentation: 1. Reviewing and revising relevant financial regulations. 2. Providing assistance to the applicant in starting a business or entering into strategic cooperation [with relevant organization]. 3. Making referrals to relevant government agencies (institutions) or organizations or funds that offer business startup assistance. If it is decided by the competent authority that relevant financial laws should be amended, the competent authority should, no later than three (3) months after the end of the innovative experimentation, complete an amendment draft of the financial laws and submit the draft to the Executive Yuan for review. • According to this report and this FSC announcement, Taiwan's first experiment will be a collaboration between KGI Bank and Chunghwa Telecom in, effectively, the **retail payment systems space**. The idea is to offer loan and credit lines based on credit scores calculated from payment records of telecom fees using big data analysis. Identity of the user would be verified by checking the IP address of the borrower's mobile phone. It seems that Chunghwa Telecom is responsible for providing relevant and accurate user data to KGI, allowing KGI to perform its big data analysis, which decides the amount of loan and credit lines. • Taiwan passed regulations under the *Experimentation Act* in July 2018, "for the purposes of providing a friendly environment for financial technology development and encouraging the use of technology to develop innovative financial products and services," and empowering the FSC to, *inter alia*, "amend financial regulations as deemed fit to facilitate financial innovation," provide funding, encourage strategic cooperation between financial institutions and those using "innovative technology", encourage financial institutions to use fintech in business development and transformation, and the like. FSC is to establish a dedicated fintech unit, effectively an innovation accelerator/sandbox
Internet Only Banks The Executive Yuan announced a Financial Development Action Plan in June 2018, which proposes changing to banking regulation not really relevant here – around funding for select industries, residential construction. However, does say "more incentives are provided for financial holding companies to merge with other financial institutions, internet-only banks are allowed to be established, and financial institutions are encouraged for innovation, in order to increase competitiveness of domestic financial institutions." Policy Announcement re internet only bank establishment, June 2018: same scope of business as commercial bank, with cap on two licenses at first. At least one of the internet bank's founders must be a bank or financial holding company with intention to achieve majority shareholding status in internet bank. Supervision, capital, fit and proper requirements apply.
Act Governing Electronic Payment Institutions (EPI Act) (2015) Article 3 : "electronic payment institution" defined as "a company approved by the [FSC] to accept, through a network or electronic payment platform, the registration and opening of an account by users that keeps track of their funds transfer and funds deposit records (referred to as "e-payment account" hereunder), and use electronic equipment to convey the receipt/payment information via connection to engage in the following businesses in the capacity of an intermediary between payers and recipients, excluding companies that engage only in business under the first subparagraph below and where the total balance of funds collected/paid and kept by them as an agent does not exceed a certain amount:

Taiwan
1. Collecting and making payments for real transactions as an agent. 2. Accepting deposits of funds as stored value funds. 3. Transferring funds between e-payment accounts. 4. Other businesses approved by the competent authority. This article describes the expansion of mobile money and e-commerce in Taiwan, while noting that many Taiwanese residents are still committed to cash or other payment systems, and noting the proliferation of different back office payment systems (a problem that has been tackled in the UK; see footnote re Bacs below)

The United Kingdom

The United Kingdom has adopted a pro-finance, pro-innovation stance. Its regulatory structure is substantially different to Canada's, and similar to Australia's: both have "twin peaks" regulators. The banking industry in the UK is undergoing radical change, particularly around the Open Banking initiative. Brexit has introduced substantial uncertainty, as well, though as of this date the UK has been subject to, and has operated in line with, important EU provisions such as the Banking Directive 1, the Payment Services Directive 2, and others.

UK
Banking Licenses: PRA and FCA have jointly established "new bank start-up unit[116]" and "new insurer start-up unit[117]" but no entry-level or restricted bank/insurer licenses available. Rules seem to be the same as they ever were List[118] from May 2018 of "challenger banks," virtually all digital with a range of business plans, which are at some stage of applying for banking licenses
Open Banking (UK's version of PSD2, with some specific elements) Openbanking.org.uk • Non-profit Open Banking Limited, established by Competition and Markets Authority in response to longstanding concerns about poor customer outcomes, will run it. Became effective 13 Jan 2018 • Uses open APIs • UK's nine largest banks must comply: HSBC, Barclays, RBS, Santander, Bank of Ireland, Allied Irish Bank, Danske, Lloyds and Nationwide • FinTech companies apply to FCA to be accepted as approved third parties ("regulated providers[119]") in order to access APIs. Currently approved TPs seem to be mix of bank-owned operations and startups. • Focus on mobile banking, money management and financial visibility, payments (allowing customers to pay directly from bank, circumventing credit cards and other middlemen), increasing competition in lending markets, reliance on trusted APIs and trusted third parties • Customer maintains control over information sharing
Non-traditional credit access for SMEs: November 2016 Bank Referral Scheme:

[116] Bank of England, "New Bank Start-up Unit" (2019), online: <www.bankofengland.co.uk/prudential-regulation/new-bank-start-up-unit>.
[117] Bank of England, "New Insurer Start-up Unit What you need to know from the PRA and the FCA" (2018), online: <www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/new-insurer/new-insurer-start-up-unit-guide.pdf?la=en&hash=310E7B09C241113F97CDDCC36F339DAF90911057>.
[118] Tanya Andreasyan, "UK challenger banks: who's who (and what's their tech)" (2018), online: <www.bankingtech.com/2018/05/uk-challenger-banks-whos-who-and-whats-their-tech/>.
[119] Open Banking, "Meet the regulated providers" (2019), online: <www.openbanking.org.uk/customers/regulated-providers/>.

UK
"the scheme requires 9 of the UK's biggest banks to pass on the details of small businesses they have turned down for finance to three Government designated finance platforms: Alternative Business Funding, Funding Options and Funding Xchange. These platforms are, in turn, required to share their details, in anonymous form, with alternative finance providers, helping to facilitate a conversation between the business and any provider who expresses an interest in supplying finance to them. … The scheme was introduced in response to evidence which shows that SMEs tend to approach their main bank when seeking finance and that, if rejected, many simply give up rather than seek alternative options. As other finance providers with different business models or risk appetites may be more willing to lend to these SMEs, this represents both an informational market failure and a significant barrier to entry for competitors in the SME lending market." Acceptance rate is about 10%
Other UK support for fintech coordination with incumbent banks British Standards Institution, Fintech Delivery Panel (November 2018, supported by HM Treasury), Publicly Available Specification[120] provides guidance on supporting fintechs in engaging with financial institutions "This … provides a guide to fintechs on the terms and approach used by many financial institutions for collaboration and commercialisation of new fintech propositions. It forms part of a wider body of work, referred to within the HM Treasury, Fintech Sector Strategy (March 2018), to develop a set of industry standards that will support fintech firms by providing them with a consistent understanding of what financial institutions will need from them before entering into partnership arrangements. … Its intention is to provide a framework that will allow fintechs to better prepare for and confirm that they are ready to engage with a large financial institution. It provides an explanation of both the commercial considerations and the necessary checks and controls that need to be satisfied to meet business and regulatory demands."
Electronic Money Regulations 2011 (under FCA) and **Payment Services** Regulations (under FCA): Description of combined effect here[121] (December 2018)

[120] The British Standards Institution, *Supporting fintechs in engaging with financial institutions – Guide*, PAS 201:2018 (London: BSI Standards Limited, 2018) at 1.
[121] Financial Conduct Authority, *The FCA's role under the Payment Services Regulations 2017 and the Electronic Money Regulations 2011*, (London: 2018).

UK
• Payment Systems Regulator[122], subsidiary of FCA, with competition orientation and responsibility for oversight of retail payment systems (including Bacs[123] (retail), CHAPs[124] (large value and wholesale), Visa and Mastercard) became fully operational on 1 April 2015. Mid-2018, announced market review[125] into competitiveness around credit cards, particularly perception that merchants are being disadvantaged by anticompetitive behaviour. • July 2017: new policy[126] to allow non-bank payment service providers direct access to RTGS settlement system (as with TIPS in EU)

[122] Payment Systems Regulator, "Homepage", (2019), online: <www.psr.org.uk>.
[123] Bacs, now owned by Pay.UK (online: www.bacs.co.uk/About/Pages/CorporateOverview.aspx), has been the company that runs Direct Debit in the UK. It also runs the Bacs Direct Credit Scheme, which is used to pay salaries and settle invoices from suppliers; and the Current Account Switch Service, which allows personal and business customers to switch banks easily. January 2018 commentary (online: www.finextra.com/blogposting/14947/what-does-open-banking-mean-for-direct-debit---and-how-does-it-tie-in-to-star-wars) on what Open Banking (a "push" system) means for Direct Debit (a "pull" system). Several new participants have joined Bacs in recent years including first non-bank payment service provider (online: www.bacs.co.uk/NewsCentre/PressReleases/Pages/IpagooFirstNonBankPaymentServiceProviderToJoinBacs.aspx), in May 2018. Bacs services were consolidated with other main retail payment systems in 2018, under Pay.uk (which was briefly called the New Payments System Operator) to create a more efficient, unified retail payment system dubbed the "New Payments Architecture".
[124] CHAPS (Clearing House Automated Payment System, online: www.bankofengland.co.uk/payment-and-settlement/chaps) is sterling same-day system that is used to settle high-value wholesale payments as well as time-critical, lower-value payments like buying or paying a deposit on a property. Direct participants in CHAPS include the traditional high-street banks and a number of international and custody banks. Many more financial institutions access the system indirectly and make their payments via direct participants. This is known as agency or correspondent banking. CHAPS payments have several main uses: (1) Financial institutions and some of the largest businesses use CHAPS to settle money market and foreign exchange transactions (2) Corporates use CHAPS for high value and time-sensitive payments such as to suppliers or for payment of taxes (3) CHAPS is commonly used by solicitors and conveyancers to complete housing and other property transactions (4) Individuals may use CHAPS to buy high-value items such as a car or pay a deposit for a house. CHAPS represents 0.5% of UK total payment volumes but 93% of total sterling payment values (excluding internalised flows within payment service providers).
[125] Steward Plant & Philip Williams, "Payment Systems Regulator announces market review" (2018), online: DLA Piper <www.dlapiper.com/en/uk/insights/publications/2018/08/payment-systems-regulator/>.
[126] Bank of England, "Bank of England extends direct access to RTGS accounts to non-bank payment service providers", (2017), online: <www.bankofengland.co.uk/news/2017/july/boe-extends-direct-access-to-rtgs-accounts-to-non-bank-payment-service-providers>.

The United States

The United States (federal level only) has entity-based regulation, as does Canada, with a distinction between banking, securities and investment banking, and insurance. Banking regulation at the federal level is fractured, and each of the Fed, the Office of the Comptroller of the Currency (OCC), the Treasury (and the Financial Stability Oversight Council, FSOC, which it chairs) and the Federal Depository Insurance Corporation (FDIC) are engaged in core banking regulatory matters. The Consumer Financial Protection Bureau (CFPB) also has a mandate over financial protection matters. Activity also takes place at the state level. In particular, state regulators can create Industrial Loan Companies (ILCs), which the FDIC's new chair has recently suggested could be a vehicle for spurring innovation. A state banking regulatory umbrella body recently asserted that they are "the primary regulators of nonbank and fintech firms." The FSB has critiqued the fragmented regulatory situation in the US, which also exists vertically between national and state regulators: US[127] (2013). *State level regulation is not covered in this report.*

US

Office of the Comptroller of the Currency (OCC), matters "incidental" to banking, and new special purpose bank charter:
• OCC is primary regulator for national bank; an independent bureau within Treasury. Supervises national banks (and others). Regulates credit cards issued by national banks. Comptroller serves as director of FDIC and member of FSOC
• Has established a Responsible Innovation[128] Office, which has developed "special purpose national bank charters"[129] for fintech firms (considering applications from 31 July 2018), Per the press release:
    o "The OCC will consider applications from fintech companies to charter a special purpose national bank that would engage in one or more of the "core banking activities" of paying checks or lending money but would not take deposits and would not be insured by the FDIC. The OCC stated that a qualified fintech company that receives a special purpose national bank charter will be subject to the same high standards of safety and soundness and fairness that all federally chartered banks must meet, and will be supervised like similarly situated national banks, including with respect to capital, liquidity, and risk management. …
        ▪ Every application will be evaluated on its unique facts and circumstances.
        ▪ Fintech companies that apply and qualify for, and receive, special purpose national bank charters will be supervised like similarly situated national banks, to include capital, liquidity, and financial inclusion commitments as appropriate. Fintech companies will be expected to submit an acceptable contingency plan to address significant financial stress that could threaten the viability of the bank.

[127] Financial Stability Board, *Peer Review of the United States,* (Financial Stability Board, 2013).
[128] U.S. Office of the Comptroller of the Currency, "Responsible Innovation", online: <www.occ.gov/topics/responsible-innovation/index-innovation.html>.
[129] U.S. Office of the Comptroller of the Currency, News Release, "OCC Begins Accepting National Bank Charter Applications from Financial Technology Companies", (31 July 2018), online: <www.occ.treas.gov/news-issuances/news-releases/2018/nr-occ-2018-74.html>.

US

- The plan would outline strategies for restoring the bank's financial strength and options for selling, merging, or liquidating the bank in the event the recovery strategies are not effective.
    - The expectations for promoting financial inclusion will depend on the company's business model and the types of planned products, services, and activities.
    - New fintech companies that become special purpose national banks will be subject to heightened supervision initially, similar to other de novo banks.
  - The OCC has the authority, expertise, processes, procedures, and resources necessary to supervise fintech companies that become national banks and to unwind a fintech company that becomes a national bank in the event that it fails.

Industrial Loan Companies (ILCs) and Innovation at the Federal Depository Insurance Corporation (FDIC):

- FDIC is concurrent regulator for national banks (in regard to depository insurance), primary federal regulator for state banks (whose deposits they also insure). Virtually all commercial banks in US must be insured by FDIC
- July 2018 announcement re FDIC setting up an "office of innovation" to encourage banks to adopt fintech strategies (presumably with primary eye on smaller banks with fewer resources, as main audience)
- Per new Chair Jelena McWilliams, October 2018[130], "FDIC could encourage innovation in three ways: The first is through the industrial loan company, a specialized banking charter supervised by the FDIC; the second way would be through the FDIC's regulation of banks' third-party vendor relationships; and the third is by working with tech companies to obtain improved processing, service and efficiency at banks"
  - April 2016[131], re-reduced "heightened scrutiny" period and higher capital requirement for new institutions from 7 years to 3 years (rescinding a change made in 2009 to increase the time period from 3 to 7 years)
- Industrial Loan Companies (ILCs):
  - Controversial: a bank charter that allows companies to own a bank w/o having to comply with Bank Holding Company Act requirements. Undated (circa 2004) summary on FDIC website here[132]
  - Have access to depository insurance, hence FDIC oversight. Capitalization, arms-length conditions, etc. still apply.
  - Available in 9 states, with Utah being the dominant one

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[130] Haggerty, "FDIC to launch innovation office", *supra* note 53.

[131] Federal Deposit Insurance Corporation, Press Release, "FDIC Rescinds De Novo Time Period Extension; Releases Supplemental Guidance on Business Planning" (6 April 2016), online: <www.fdic.gov/news/news/press/2016/pr16027.html>.

[132] Federal Deposit Insurance Corporation, "The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective", online: <www.fdic.gov/regulations/examinations/supervisory/insights/sisum04/industrial_loans.html>.

US
◦ Apparently of interest to fintechs that want to offer fuller range of services including taking deposits: student online lender SoFi[133] applied then withdrew application, 2017; Square applied then withdrew, but claims continued intention to become ILC in Utah.
Consumer Financial Protection Board (CFPB): • Consumer protection mandate, including over credit cards not regulated by OCC ▪ Proposed "disclosure sandbox[134]" to test new communication ideas w customers (Sept 2018)
Reports of Note <u>The Federal Reserve</u> • Central bank, lender of last resort (for national banks overseen by OCC). The Fed must approve acquisitions of banks, and banks' acquisitions of other banks and approved non-bank subs. The Fed is not a banking regulator per se, except with regard to supervising designated SIFIs per FSOC • Has established FedPaymentsImprovement[135] initiative, which has launched ◦ Faster Payments Task Force[136] (2017). Among other things, an outcome was for the Fed to allow joint access to Fed accounts by multiple parties (e.g., a mainstream bank and a payment service provider); issues of speed, interoperability, accessibility, other challenges remain. (Also a Secure Payments Task Force[137]) ◦ Next Steps[138] document (2017) sets agenda for future work around 5 topics: speed, security, efficiency, international (meaning cross-border payments), and collaboration (with stakeholders in the US) <u>Treasury</u> • Fintech Report[139] July 2018 – see *Appendix B* @ p. 197 for Table of Recommendations, summarized in: "opportunities to modernize regulation to embrace the use of data, encourage the adoption of advanced data processing and other techniques to improve business processes, and support the launch

[133] Harris, "Are you ready to ditch your bank?", *supra* note 54.
[134] Consumer Financial Protection Bureau, "CFPB Office of Innovation proposes "disclosure sandbox" for companies to test new ways to inform consumers" (13 September 2018), *Consumer Financial Protection Bureau* (Blog), online: <www.consumerfinance.gov/about-us/blog/cfpb-office-innovation-proposes-disclosure-sandbox-companies-test-new-ways-inform-consumers/>.
[135] Federal Reserve Banks, "Homepage", online: <fedpaymentsimprovement.org>.
[136] Faster Payments Task Force, "The U.S. Path to Faster Payments", online: <fasterpaymentstaskforce.org>.
[137] Secure Payments Task Force, "Homepage", online: <securepaymentstaskforce.org>.
[138] Federal Reserve System, "Strategies for Improving the U.S. Payment System Federal Reserve Next Steps in the Payments Improvement Journey", (Washington: 2017).
[139] U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation*, (Washington: 2018).

US
of alternative product and service delivery systems. Support of innovation is critical across the regulatory system — both at the federal and state levels. Treasury supports encouraging the launch of new business models as well as enabling traditional financial institutions, such as banks, asset managers, and insurance companies, to pursue innovative technologies to lower costs, improve customer outcomes, and improve access to credit and other services. … Treasury's recommendations in this report can be summarized in the following four categories: o Adapting regulatory approaches to changes in the aggregation, sharing, and use of consumer financial data, and to support the development of key competitive technologies; o Aligning the regulatory framework to combat unnecessary regulatory fragmentation, and account for new business models enabled by financial technologies; o Updating activity-specific regulations across a range of products and services offered by nonbank financial institutions, many of which have become outdated in light of technological advances; and o Advocating an approach to regulation that enables responsible experimentation in the financial sector, improves regulatory agility, and advances American interests abroad. Financial Stability Oversight Council (FSOC) • Systemic stability mandate, chaired by Treasury • Annual Report 2018[140] discusses New Financial Products and Services starting at p. 87 – *really just a watching brief*. o Has established Digital Assets Working Group o Discuss P2P payments and marketplace lending (in which "model has evolved to one that uses significant capital from institutional investors to finance consumer and small business loans"); acknowledge potential entry of large tech firms into financial space; acknowledge potential risks of financial institutions relying on TPPs for operational functions and data gathering, including on the cloud
Payment systems More research can be done if needed, but note that at the **retail** level: o The OCC regulates credit cards issued by federal banks o e.g., PayPal is regulated as "money transmitter" on state-by-state basis

[140] United States, Financial Stability Oversight Council, *2018 Annual Report*, (Washington: 2018).

US
○ June 2018: SCOTUS ruled, in Sherman Antitrust matter brought by DoJ against AmEx in *Ohio v American Express*, 585 U.S. ___ (2018),[141] that merchants could not suggest to customers that bring out AmEx cards that they use another method of payment. More research required to understand broader impact on hopes for open banking in US.
State regulators now asserting a role as "the primary regulators of nonbank and fintech firms". State banks are not part of Federal Reserve system Certain states (e.g., Arizona) have begun to try to become hubs of fintech activity through more flexible licensing regimes. This may have been the catalyst for Conference of State Bank Supervisors (CSBS) Vision 2020:[142] plan is that by 2020, "state regulators will adopt an integrated, 50-state licensing and supervisory system, leveraging technology and smart regulatory policy to transform the interaction between industry, regulators and consumers." • Oppose[143] OCC special purpose bank charters above • Has established "Fintech Industry Advisory Panel" to provide" industry input to help states: modernize regulatory regimes; identify points of friction in licensing and multi-state regulation; and discuss a wide array of solutions. The panel will focus on payments and money transmission; lending; and community banks and innovation." Aims to develop a "Redesigned Nationwide Multistate Licensing System (NMLS) - the common platform for state regulation - will transform the licensing process thru data/analytics; automate most new applicants; and enable states to focus more on higher-risk cases while streamlining state regulation on a multi-state basis."

[141] Adam Liptak, "Supreme Court Sides with American Express on Merchant Fees", *New York Times* (25 June 2018), online: <www.nytimes.com/2018/06/25/us/politics/supreme-court-american-express-fees.html>.
[142] Conference of State Bank Supervisors, "Vision 2020 for Fintech and Non-Bank Regulation", online: <www.csbs.org/vision2020>.
[143] Conference of State Bank Supervisors, "The OCC Fintech Charter", online: <www.csbs.org/occ-fintech-charter>.