Consultation on the Review of the *Canadian Payments Act*

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Related Document

News Release: Department of Finance Canada Launches Consultations on the Review of the *Canadian Payments Act*

Invitation for Comments

Closing date: July 24, 2018

Written comments should be sent to:

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In order to add to the transparency of the consultation process, the Department of Finance Canada may make public some or all of the responses received or may provide summaries in its public documents. Therefore, parties making submissions are asked to clearly indicate the name of the individual or the organization that should be identified as having made the submission. Submissions should preferably be provided electronically in PDF format or in plain text to facilitate posting.

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Overview

Payment systems are integral to support economic activity in Canada. Ensuring that these systems are fast, secure, reliable, and flexible allows consumers and businesses to transfer value safely and efficiently. The payments ecosystem is an area of rapid evolution and innovation – mobile platforms, e-commerce, and new players are changing the way Canadians want to pay, and Canada's core payments systems must change to meet this demand.

Payments Canada (formally known as the Canadian Payments Association) owns and operates Canada's core payment clearing and settlement systems. The *Canadian Payments Act* (the Act) establishes Payments Canada and sets out its legal requirements, including its mandate, the institutions eligible for membership, and the oversight responsibilities for the Minister of Finance. Payments Canada is a public purpose organization with a duty to promote the efficiency, safety, and soundness of its systems while taking into account the interests of users. Payments Canada is also mandated to facilitate the development of new payment technologies. Amendments to the *Canadian Payments Act* were brought into effect in 2015 to reform the governance structure of Payments Canada, with an aim to ensure that core systems are operated for the benefit of Canadians and support competition and innovation in the payments space. Shortly following these changes, Payments Canada launched a program to modernize Canada's core payment systems, with an objective to allow for more open, risk-based access to its modernized systems.

As part of the 2015 legislative changes, a review clause was added to the Act to require its review three years following the coming into force of the amendments. The review provides an opportunity to consider whether the 2015 governance changes are working to achieve the intended policy objectives of efficiency, safety and soundness, and user interests. In light of Payments Canada's modernization initiatives and the recent consultations on a new retail payment oversight framework, this review also provides an opportunity to seek views on how best to adapt Payments Canada's membership structure to ensure access to its systems reflects developments in the payments market while ensuring the ongoing policy objectives are achieved.

1. Introduction

In 2017, Canadians made roughly $200 billion worth of payments each day using Payments Canada's systems, totalling more than $50 trillion on an annual basis. These transactions reflect the pulse of the Canadian economy and is vital to its operation. Consumers' expectations for payments experiences are changing – they anticipate the ability to use their mobile and other devices with speed and convenience, without having to compromise on privacy or security. Meanwhile, businesses are looking for data-rich payment options that facilitate automated back-office operations, enabling the elimination of paper-based payment items and manual reconciliation.

The payments system consists broadly of infrastructure, including institutions and arrangements, which allow consumers, businesses, financial institutions, and other organizations to transfer value to one another. Under the *Payment Clearing and Settlement Act*, the Bank of Canada is responsible for designating and overseeing financial market infrastructures (FMIs) which have the potential to pose systemic or payments system risk. Payments Canada's Large Value Transfer System (LVTS), an electronic funds transfer system that settles large-value and time-critical Canadian dollar payments, has been designated by the Bank of Canada as systemically important to Canada's financial system. Payments Canada's Automated Clearing Settlement System (ACSS), used primarily for clearing of retail payments, has been designated by the Bank of Canada as a prominent payment system, meaning that it has the potential to cause payment system risk. The Bank of Canada applies risk management standards for payment systems that are proportionate to the level of risk that a payment system can pose to the Canadian financial system and the economy.

Although the Bank of Canada neither owns nor operates Payments Canada's systems, the Bank of Canada has a keen interest and involvement in these systems as part of its broader responsibility to promote the efficiency and stability of the financial system. As such, it plays other roles in LVTS and ACSS, including the role of settlement bank so that settlement in LVTS and ACSS is conducted in central bank money.

In 2010, the Government announced the creation of the Task Force for the Payments System Review to conduct a comprehensive review of the Canadian payments system. In 2012, the Task Force released its final report, which included a number of recommendations for future strengthening of the payment system in Canada. As part of this work, the Task Force identified challenges with respect to Payment Canada's governance structure. In particular, the Task Force found that members of Payments Canada's board of directors were conflicted in their duties to the Association and their respective employers.

In 2015, the Government amended the *Canadian Payments Act* to strengthen Payments Canada's governance framework, facilitating greater independent decision-making by Payments Canada's board of directors and improving Payments Canada's accountability framework.

Less than a year after the new governance framework was in place, Payments Canada released a series of consultation papers to articulate a vision and the motivation for renewing Canada's core payment system infrastructure. In December 2017, Payments Canada released the *Modernization Target State,* which provided detail on how Payments Canada intends to meet its objectives for modernization.

Modernization will entail the replacement of Payments Canada's older infrastructure and the creation of new systems. Launched in 1999, the LVTS will be replaced with a safer, more flexible and resilient high value payment system (Lynx) and the ACCS, launched in 1984, will be gradually replaced with a more efficient retail system (the Settlement Optimization Engine (SOE)). A new real-time retail payment system ("real-time rail") will be developed as a third core payment system to better serve the needs of consumers and merchants and to provide a platform for innovation in the Canadian payments ecosystem. Access to the real-time rail, as with all core payment systems, will be open and risk-based, which is consistent with CPMI-IOSCO[1]'s Principles for Financial Market Infrastructures (PFMIs).[2] The PFMIs also state that final settlement of obligations in a payment system should be in central bank money where practical and available. As it currently does for LVTS and ACSS, the Bank of

Canada will provide settlement accounts to the participants of Payments Canada's three new systems.

Other countries have taken similar steps to modernize their core payment systems, generally through development of faster payments platforms, enabling data-rich messaging standards, and broadening access for non-traditional financial service providers through either direct participation or sponsored access by a participating financial institution. Recent examples include the Bank of England's decision to renew and open up its core systems, the rise of cross-border payments in the Single European Payment Area, and the launch of the Australian Payments Network's New Payments Platform to enable faster payments.

The pace of change in the retail payments landscape is both a global and domestic phenomenon. The Department of Finance launched consultations in July 2017 on a new retail payment oversight framework to facilitate the evolution of the Canadian retail payments ecosystem in such a way that payment services remain reliable and safe for end-users, while supporting competition and innovation in the payments ecosystem. Certain retail payment service providers (PSPs) are currently not subject to comprehensive oversight, which can raise risk, competition, and efficiency concerns for payment service providers and end-users. The proposed oversight framework would serve to close this gap, and would apply to any PSP performing certain payment functions in the context of an electronic funds transfer. Some of these payment service providers are currently not eligible for Payments Canada membership.

2. Motivation for the review

In light of these developments, the Department of Finance is seeking views on two targeted themes under the *Canadian Payments Act.* First, the Department is seeking views on the impact of the 2015 governance changes in achieving intended public policy objectives.

Second, the Department is seeking views on Payments Canada's current membership structure in light of developments in the payments ecosystem and Payments Canada's modernization initiatives. Specifically, feedback is sought on membership eligibility related to the Government's proposed retail payment oversight framework in the context of the new RTR and SOE retail payment platforms. Views on membership in the context of the new Lynx platform are also sought.

The Department is seeking stakeholder feedback on these two themes to determine what changes may be required to best achieve a continued balance of the Government's three public policy objectives:

1. *Safety and soundness* – With regard to payments, safety and soundness refers to the appropriate measurement, management, and control of risks. Safety and soundness are essential conditions to achieve a stable financial system and a well-functioning economy. Given the potential to transmit negative shocks, payment systems and services must be operated with appropriate regard to safety and soundness. The *Canadian Payments Act* should ensure that the governance and operation of Canada's core payment systems include appropriate safeguards to ensure that Payments Canada can respond to the oversight requirements of the Bank of Canada.

2. *Efficiency* – Efficiency in payments includes how effectively the payment exchange, clearing and settlement processes are carried out to meet end-users' needs, as well as ensuring the efficient allocation of resources to deliver services. The *Canadian Payments Act* should ensure that the governance and operation of Canada's core payment systems fosters innovation, technological advancement, and competitive market conditions, while removing unnecessary barriers to entry where appropriate.

3. *User interests* – Payment systems and services should be designed and operated to meet the needs of Canadians and protect end-user interests. These needs include fast and secure payment systems that can process data-rich payments and may serve as adaptable platforms for new and existing use cases. End-user interests are not homogenous and are reflective of a wide range of needs of both businesses and consumers. The *Canadian Payments Act* should ensure that the governance and operation of Canada's core payment systems is carried out in the public interest, taking into account the interests of users.

Taken together, these core objectives provide context for assessing whether the *Canadian Payments Act* is functioning effectively.

3. Payments Canada Governance

Payments Canada, recognized legislatively as the Canadian Payment Association (CPA), is governed by the *Canadian Payments Act* and was created in 1980 by an Act of Parliament. Payments Canada is a corporation that operates on a not-for-profit basis, and while it is not a Crown corporation, the organization carries out a public purpose function in the operation of Canada's core payment clearing and settlement systems. Specifically, Payments Canada's mandate is to:

1. Establish and operate national systems for the clearing and settlement of payments and other arrangements for the making or exchange of payments;

2. Facilitate the interaction of its clearing and settlement systems and related arrangements with other systems or arrangements involved in the exchange, clearing or settlement of payments; and

3. Facilitate the development of new payment methods and technologies.

In pursuing these objectives, Payments Canada must take into account public policy objectives to promote the efficiency, safety, and soundness of its clearing and settlement systems and consider the interests of users.

In addition to setting out the mandate and objects of Payments Canada, the *Canadian Payments Act* sets out the legal framework for the organization, including the role and responsibilities of the board, the oversight responsibilities of the Minister of Finance and the institutions eligible for membership.

While Canadian banks and the Bank of Canada are required to be members of Payments Canada, other institutions[3] are eligible for membership. Payments Canada had 110 members as of the end of 2017. Payments Canada's members may participate either directly or indirectly in Payments Canada's systems. Payments Canada is governed by a board of 13 directors, comprised of an independent chairperson, six independent directors, five member directors, and the President and CEO of Payments Canada.

Payments Canada has two advisory councils established under the Act to provide advice and counsel to the board of directors. The Stakeholder Advisory Council (SAC) is comprised of a broad stakeholder base of payment system service providers and users of payment services. The Member Advisory Council (MAC) is comprised of Payments Canada members broadly representative of the organization's diverse membership.

Payments Canada is fully funded by its members which are required to pay common service dues for membership. In addition, Payments Canada funds its operations through transaction fees charged to members who use the core systems.

3.1 Changes to Payments Canada's Governance structure in 2015

In its final report published in 2012[4], the Task Force on the Payments System Review identified several areas with regards to Payments Canada's governance structure that warranted change. In particular, the Task Force found that in its decision-making, members of the board of directors faced conflictions in their duties to their respective employers and their duty to uphold public interest objectives under the CPA's mandate. Following a budget announcement and amendments introduced in 2014, changes to the *Canadian Payments Act* came into force in 2015 to ensure that Canada's core payments clearing and settlement infrastructure continued to be operated for the benefit of Canadians and Canadian businesses. Amendments introduced greater independent decision-making to Payments Canada's board of directors and strengthened its accountability to the Government and to the public. Highlights of the 2015 governance changes are outlined below.

3.1.1 Independent Board

Prior to 2015, Payments Canada's board of directors was comprised of 16 individuals, 13 of whom were drawn from Payments Canada's membership, including the chair of the board, who was an appointed official of the Bank of Canada. Three of the board members were appointed by the Minister of Finance.

The board is now comprised of 13 members, the majority of whom are independent. Specifically, five of the 13 directors are drawn from Payments Canada's membership, seven are independent directors, with the final director being the CEO and President of Payments Canada who serves as an *ex officio* director. The Bank of Canada no longer sits on the board (or acts as chair) and the Minister of Finance no longer appoints any of the directors. Of the five member-directors, three hold settlement accounts at the Bank of Canada, while the remaining two directors are drawn from Payments Canada's remaining members.

While the concept of independence is not defined in the Act, the test of independence may be found in associated regulations and is defined as having no direct or indirect material relationship to the organization or a member. Elected directors (those other than the President and CEO, who is appointed by the board) serve a term of three years, renewable once. The chair and deputy chair of the board of directors must be selected by the elected directors from the seven independent directors.

This majority-independent board of directors is intended to allow for decisions to be made in the broader public interest, with appropriate input and participation by member-directors with specific and diverse payments systems expertise. A relatively small board of directors is intended to allow for efficient dialogue and decision-making, in line with governance best practices.

3.1.2 One member one vote

Prior to 2015, Payments Canada operated under a volume-based voting structure for elected directors, whereby various classes of members were allotted votes in proportion to their respective volume of payment items processed through Payments Canada's systems in the preceding year of election.

Following the 2015 changes, under the Act, each member is now entitled to one vote on all matters to be decided by members. In this regard, all members are entitled to a vote for each elected director position.

The intention of the new voting structure is to ensure equality of voting rights, such that voting power is not condensed into the hands of a select few larger participants.

3.1.3 Nominating Committee

In 2015, the concept of a nominating committee was introduced into the Act. Now, a nominating committee composed of elected directors, a majority of whom must be independent directors, must be appointed to identify potential independent directors and member-directors to stand for election. In selecting member-directors, the nominating committee must ensure that candidates are broadly representative of the diversity of Payments Canada's membership.

The use of nominating committees for evaluating potential board of director candidates is common practise in organizations. It sets a robust foundation for a well-functioning board, and helps to facilitate timely replacement of board members when terms expire.

3.1.4 Accountability

Prior to 2015, Payments Canada was not required to formally report to government, or publish an annual report or financial statements.

Payments Canada is now legislatively required to annually submit a five-year corporate plan for approval by the Minister of Finance. The plan must include Payments Canada's objectives over the period, strategies that will be employed to achieve those objectives, expected performance over the five-year period, and capital and operating budgets. Payments Canada is also required to produce a publicly-available annual report on the operations of the organization which must include financial statements and the report of the auditor on those statements.

These requirements are intended to support Payments Canada's accountability to the government and Canadians in serving its public purpose mandate.

3.1.5 Directives

Prior to 2015, the Minister of Finance had the legislative authority to direct Payments Canada to make, amend or repeal any of Payments Canada's rules or bylaws. The Minister of Finance's directive power was broadened in 2015 to include directives that may be related to issues beyond the scope of bylaws and rules.

Now under the Act, the Minister of Finance may issue a written directive to Payments Canada, if he or she is of the opinion that it is in the public interest to do so. The Minister's current directive power is in line with the directive power the Minister has over Crown corporations under the *Financial Administration Act.*

3.1.6 Advisory Councils

As part of the suite of governance changes, a Member Advisory Council was created under the Act as a complementary consultative forum to the Stakeholder Advisory Council, which existed under the Act prior to 2015. The Stakeholder Advisory Council, comprised of a broad base of users and payment service providers, is mandated to provide counsel and advice to the board on payment clearing and settlement matters and any other matters related to the objects of Payments Canada.

Now, under the Act, the board must appoint Payments Canada members to a Member Advisory Council, which has an objective to provide counsel and advice to the board of directors on the operation of clearing and settlement systems, the interaction of those systems with other systems, and the development of new technologies. The Member Advisory Council serves as a consultative and engagement forum for participating member financial institutions.

3.1.7 Review

As noted above, as part of the suite of governance changes made in 2015, a review clause was added to the Act to require the Minister of Finance to conduct a review of the Act and its operation three years following the coming into force of the amendments, and to table a report on the review in both houses of Parliament upon completion of the review.

3.2 Questions for consultation

The Department of Finance is seeking views on the effectiveness of the 2015 amendments to the *Canadian Payments Act* in achieving the policy objectives of efficiency, safety and soundness, and user interests, as described in detail in section 2. The questions that follow are intended to help guide stakeholder feedback in assessing the impact of the 2015 governance changes through the lens of these three policy objectives.

1. *Have the 2015 changes to Payments Canada's governance been successful in better enabling the organization to achieve its public policy mandate to promote the efficiency, safety, and soundness of its systems while taking into account the interests of users?*
2. *Are there aspects of Payments Canada's governance structure that could be*

improved to better allow Payments Canada to carry out its mandate and serve its public policy objectives?

4. Membership

Under the *Canadian Payments Act*, Payments Canada members are afforded the right to present payment items on Payment Canada's systems, and are thus obliged to arrange for settlement of those items. Banks, and authorized foreign banks, are required to be members under the Act, while others, such as credit union centrals, life insurance companies and securities dealers, are eligible to be members. Members participate actively in Payments Canada's governance framework and are afforded voting rights, as discussed in section 3.

Membership in Payments Canada does not provide an entity an automatic right to exchange, clear or settle directly on Payments Canada's systems. In order to do so, entities must meet participation requirements set by Payments Canada, reflective of the additional risks that come with these additional privileges and functionalities. In order to settle directly in Payments Canada's systems, they must also meet the Bank of Canada's requirements for a settlement account. System participants, and Payments Canada, must trust that participants will settle any obligations and must trust that risks are appropriately mitigated. Mutual trust and confidence among members and Payments Canada, the foundations of which are set out in the *Canadian Payments Act*, is required for the smooth operation of core payment systems.

The existing structure for mandatory and eligible members under the Act reflects the fact that these members face appropriate regulatory oversight under federal and/or provincial regulatory regimes. These regimes impose a high standard of oversight and regulatory requirements, which may include liquidity and capital requirements, operational, technical and legal requirements, business practice and governance requirements, as well as appropriate access to liquidity support and regimes for resolving situations of financial non-viability.

The Department is seeking views on membership to support the objective of open, risk-based access to the three new payment systems that will be operated by Payments Canada – the RTR, the SOE, and Lynx. The relative openness of access to each of these core systems is a function of the impact that a disruption on each system would pose to the financial system and the economy, counterbalanced by the objectives of efficiency and user interests. The figure below highlights this relationship. For Lynx, which will be a systemically important payment system, considerations of safety and soundness are most critical and access would therefore be restricted appropriately to limit risk. The SOE, which will be a prominent payment system, could feature broader access and participation relative to Lynx. The RTR, on which a disruption would have the least impact on the financial system and the economy, should feature the broadest access compared to the other two systems.

4.1 Membership – RTR and Retail payments oversight

As part of its modernization initiative, Payments Canada is developing a new real time payment system, the RTR, with an objective to better serve the needs of consumers and merchants and to provide a platform for innovation in the Canadian payments ecosystem. The RTR will offer consumers near-instant receipt of funds, more convenient payment methods, and the ability to receive payments without needing to provide sensitive account information. International messaging standards will offer enhanced global interoperability, more detailed remittance information attached to payments, and simpler reconciliation than existing payment methods.

Access to the RTR will be open and risk based, in alignment with PFMI standards. This creates an opportunity for a broad base of direct exchange participants on the RTR, without compromising on the safety and soundness of the systems. To facilitate open and risk-based access, the RTR is expected to settle on a real-time gross basis, with payments fully pre-funded by cash balances in settlement accounts at the Bank of Canada. Such a model facilitates broad access by eliminating credit risk between participants. Broader access, including to entities who may not currently be Payments Canada members, could help foster competition in the payments ecosystem. In conjunction with these developments, the Department of Finance recently undertook consultations on a proposed retail payments oversight framework for PSPs. In the consultation paper, *A New Retail Payments Oversight Framework*, five core functions performed by PSPs in the context of electronic fund transfers were identified: provision and maintenance of a payment account, payment initiation, authorization and transmission, holding of funds, and clearing and settlement.

Under the proposed framework, PSPs would be subject to principles-based oversight with operational requirements including security and risk management practices, end-user fund safeguarding, and market conduct, for instance:

- To mitigate operational risks, the oversight framework would require PSPs to comply with principles related to establishing security and operational objectives, policies, and business continuity planning. These would include comprehensive physical and information security policies that address all major vulnerabilities and threats.

- To safeguard user funds, PSPs would be required to place end-user funds held overnight or longer in a trust account at a deposit-taking financial institution that is either a member of the Canadian Deposit Insurance Corporation or covered under a provincial deposit insurance regime or to provide similar levels of protection.
- As part of market conduct measures, PSPs would have to disclose to end users' information on the key characteristics of the service or product.
- Payment-authorizing PSPs would have to refund the payor for losses resulting from unauthorized transactions or errors.
- All PSPs would be required to apply for registration with the designated federal retail payments regulator.

The proposed oversight framework for PSPs could be leveraged to facilitate a wider range of participation in, and access to, the RTR platform, as well as Payments Canada operated exchange networks for electronic payments streams that will clear through the SOE.

Currently, under the Act, these non-traditional PSPs are not eligible to be Payments Canada members, and therefore cannot legally present payment items on any of Payments Canada's systems. The Department of Finance is considering how to best align the existing Payments Canada membership structure with the proposed retail payments oversight framework, with a view to grant PSPs regulated under the retail payments oversight framework appropriate, risk-based access to the RTR.

Regulation under the retail payments oversight framework would serve to provide a baseline level of assurance to consumers, other payment system participants, and Payments Canada in dealing with non-traditional PSPs. Non-traditional PSPs regulated under the retail payment oversight framework, however, may not be subject to the same level of regulatory scrutiny as existing Payments Canada members, which are generally complex prudentially regulated financial institutions or other regulated organizations.

4.1.1 A proposed Associate Membership framework

In light of the objective for open, risk-based access, the Department of Finance is seeking views on the merits of an "associate membership" framework under the Act which would render non-traditional PSPs, once regulated under the proposed retail payment oversight framework, eligible to participate in exchange and settlement of payment items on the RTR system. Associate members would not be eligible to participate in systemically important payment systems, including the LVTS and the future Lynx system. Considerations around associate member participation in the SOE will be discussed in section 4.2 below. Under this proposal, PSPs regulated under the retail payment oversight framework would be eligible to apply for associate membership. Associate members would be separate and distinct from members, with a separate set of rights and obligations, and subject to Payments Canada's compliance and enforcement standards.

Currently, under the Act, membership status does not give an entity the automatic ability to exchange, clear, or settle payments directly on Payments Canada systems – in order to do so, entities must meet additional requirements set by Payments Canada and the Bank of Canada for direct exchange and direct settlement capacity respectively. As is the case with existing Payments Canada members, associate members would also be required to meet any system-specific requirements set out by Payments Canada before obtaining access to the RTR system. Should associate members wish to settle their obligations directly through the RTR, they would also have to meet requirements set by the Bank of Canada to obtain an RTR settlement account.

The Department of Finance is seeking views on the merits of a proposed associate membership framework, advancing the public policy objectives of efficiency, safety and soundness, and meeting the needs of users, as described in section 2.

The Department is seeking views on the design elements of this framework, as outlined below. The questions that follow are intended to help guide stakeholder feedback on the main components of an associate membership framework. Feedback is welcome on any of the following elements.

4.1.1.1 Preconditions

In order for a PSP to be entitled to apply for associate membership, the PSP would have to be regulated and registered under the proposed retail payments oversight framework. This proposed precondition for eligibility reflects the reliance on the oversight of the retail payments regulator to ensure that certain requirements for operations including security and risk management practices, and user fund safeguarding are met by the PSP, as described in section 3.4.

Except for banks, authorized foreign banks, and the Bank of Canada, who are required to be members of Payments Canada, other eligible entities must apply for membership with Payments Canada through an application process. The Department proposes that entities entitled to apply for associate membership also be required to apply for associate membership status with Payments Canada through an application process.

In the event that an associate member fails to meet the requirements of the retail payment oversight regulator (e.g., if the regulator finds the PSP to be non-compliant), the rights of that associate member could be suspended or revoked.

4.1.1.2 Governance

Existing Payments Canada members participate in the governance of the organization in a variety of ways. Some members participate directly on the board of directors, while others participate on the Member Advisory Council. Some members participate in neither forum, but exercise their voting rights for matters on which they have the right to decide, and participate in member forums on an ad-hoc basis.

Similarly, under the proposed associate membership framework, the views of associate members should be appropriately reflected in Payments Canada's decision-making, advisory, and voting processes. In particular, consideration is being given to how associate members should, or should not, participate at the board level. Currently, Payments Canada's board is comprised of 13 members – of the five member-directors, 3 are large direct participants in Payments Canada's systems with settlement accounts at the Bank of Canada, while the remaining two directors are drawn from Payments Canada's remaining members.

Consideration is also being given to how best to enable Payments Canada, and its membership, to draw from associate members' expertise, and vice versa. Several PSPs currently participate in the SAC forum as non-member stakeholders. It may no longer be appropriate for PSPs who have established themselves as associate members to participate on SAC. With the changing constituency of the SAC, considerations around the role and focus of the council may need to change. Consideration must also be given as to how best to incorporate associate members into the MAC forum.

Existing Payments Canada members are granted one vote each for all matters which may be decided on by a member vote. Consideration is being given to how associate members could be incorporated into this voting structure.

4.1.1.3 Liability

Currently under the Act, Payments Canada's liability, and that of its members, may be limited for any loss or damage suffered by a member as a result of anything done in accordance with Payments Canada's bylaws and rules. Increasing the number and types of entities connected to Payments Canada's systems through a proposed associate membership framework, or by changing the role Payments Canada plays by operating a new RTR, could increase liability risk. Consideration is being given to how Payments Canada's ability to limit liability will need to adapt to these developments.

4.1.1.4 RTR Exchange

Bylaws and rules made under the Act set out criteria which members must meet in order to participate on Payments Canada's systems. These criteria and requirements are reflective of the additional operational and technical risks associated with participation.

Once operational, a bylaw made under the Act would set out eligibility criteria for member participation on the RTR system. Additional requirements would be contained in Payments Canada rules.

Like members, associate members would be required to meet the eligibility criteria in order to exchange on the RTR. These criteria would include requirements related to operational capacity, for instance, reporting procedures, testing, message format, and routing requirements, in addition to cybersecurity requirements.

Payments Canada will shortly consult on its overall policy framework for participation on the RTR, and will subsequently develop risk-based participation requirements.

Payments Canada members are currently required to pay both common service dues to cover services which are of equal benefit to members, and transaction fees based on usage of core systems. A modified funding model, for fees and potentially dues, paid to Payments Canada by associate members will also be required, and should be designed so as not to create any barriers to entry to the RTR.

4.1.1.5 RTR Settlement

Associate members exchanging on the RTR will need to arrange for settlement of payments. As in other payments systems, settlement in RTR can be done directly or indirectly via another participant. Participants who wish to settle directly will need to obtain an individual settlement account at the Bank of Canada. Given payments in RTR need to be fully pre-funded with cash, such participants would also either need to be a direct Lynx participant or have banking arrangements in place with a direct Lynx participant to send payments to fund their RTR settlement account. Associate members would not have access to central bank credit.

To support the objective of more open, risk-based access, the Bank of Canada will provide an individual settlement account to either a member or an associate member who wishes to settle directly, provided they meet the financial, operational, and other requirements set by the Bank of Canada. The requirements from the Bank of Canada's settlement account policy are not part of the *Canadian Payments Act* review.

The Bank of Canada is developing minimum requirements for access to a settlement account for each of the new systems – Lynx, the SOE, and the RTR. In developing these requirements, the Bank of Canada will balance the benefits and risks associated with broadening access to its settlement accounts.

1. *Should the Government create an associate membership class to facilitate access to the RTR? Should alternate approaches be considered?*
2. *Should registration and regulation under the proposed retail payments oversight framework be a pre-condition for associate membership?*
3. *How could Payments Canada's governance structure be adapted to allow for appropriate reflection of associate member views into Payments Canada's decision-making process? In what ways could this be designed?*

4.2 Membership – SOE

The ACSS system is critical to the clearing and settlement of the vast majority of retail payments in Canada. In May 2016, the Governor of the Bank of Canada designated the ACSS as a prominent payment system, bringing it under the formal oversight of the Bank of Canada and requiring Payments Canada, as operator of the ACSS, to meet the Bank of Canada's risk management standards for prominent payment systems.

The ACSS is a deferred net settlement system. Credit risk for direct ACSS participants (known as direct clearers) is managed via a loss-sharing arrangement whereby collateral is pledged to the Bank of Canada for the purpose of the settlement of clearing balances in the event of a participant's default. Given this, direct clearers should be prudentially regulated and maintain very high risk management standards.

Indirect ACSS clearers are Payments Canada members who exchange, clear and settle on the ACSS with a direct clearer acting as agent. They do not directly participate in the ACSS loss-sharing arrangement.

The SOE will replace the ACSS for the purpose of clearing and settling retail payments made by individuals and business through paper or electronic methods. The SOE will be designed to provide better risk management than the ACSS and to meet the Bank of Canada's standards for Prominent Payment Systems. In line with these standards, and the requirement for open, risk-based access, the SOE may separate participation in the exchange of payments from their clearing and settlement, giving members more options for how they participate in the SOE. Members that participate only in exchange are not expected to be part of the ACSS loss-sharing arrangement and would clear and settle with a direct clearer acting as agent.

Given the proposal for associate membership presented in section 4.1.1, consideration is being given to whether associate members should also be eligible to, directly or indirectly, exchange electronic payment items on SOE exchange networks, should they meet Payments Canada's access criteria. Associate members would not be eligible to settle items exchanged in the SOE and would have to have an arrangement with a settlement member in this regard.

Payments Canada will shortly consult on its overall policy framework for participation on the SOE, and will develop risk-based participation requirements following that.

4.3 Membership – Lynx and Systemically important FMIs

Sitting at the heart of the financial system, the LVTS settles high value, time sensitive payments, some of which are related to the risk controls and settlement of other systemically important and prominent payment systems.

As part of its modernization, Payments Canada aims to ensure its new systems are designed to continue to meet regulatory standards relating to the Bank of Canada's designation of its systems as important to the smooth functioning of the Canadian economy. Lynx will replace the LVTS and feature fully collateralized real-time gross settlement of large value payments, removing the need for residual guarantees from the Bank of Canada. Like the LVTS, Lynx is expected to be designated as a systemically important payment system and will be designed to comply with the Bank of Canada's standards for Systemically Important Payment Systems that are based on the PFMIs. Given Lynx's systemic importance, it is expected that only those prudentially regulated members that meet high risk management standards would be eligible to access Lynx.

The Governor of the Bank of Canada has designated several FMIs as systemically important under the *Payments Clearing and Settlement Act*. This public interest designation provides the Bank with oversight of these systems to ensure they are operated in a manner that minimizes systemic risk. Currently, the Bank acts as the settlement agent for the designated FMIs. Final settlement of FMI obligations are effected by LVTS payments sent to/from FMI accounts held at the Bank of Canada.

Consideration is being given to whether FMIs that are designated as systemically important should be eligible for direct access to Lynx for the purpose of effecting settlement, thereby allowing the operator of these systems to directly send and receive Lynx payments rather than relying on the Bank. Given the nature of these arrangements and the fact that designated FMIs are overseen by the Bank and must meet stringent risk management standards, risk exposure to Lynx and Lynx participants would be limited. Systemically important FMIs are not currently eligible for direct access to LVTS (or in the future, Lynx) under the Act as they are not legislatively eligible for Payments Canada membership.

1. *What are your views on whether and how to broaden membership so that systems that are designated by the Bank of Canada as systemically important financial market infrastructures can directly access Lynx?*

5. Next Steps

The rapid evolution of the Canadian payments ecosystem necessitates continued dialogue between the Government and stakeholders to ensure that the existing framework for the governance and operation of Canada's core payment systems continues to achieve intended policy objectives. The Government invites all stakeholders to participate in this consultation process. By working together, we can ensure that the Canadian payments system continues to function efficiently and competitively, while maintaining high standards of safety and soundness, and meeting the needs of Canadian consumers and businesses. The Government will produce a report to be tabled in both houses of Parliament based on feedback from stakeholders on this consultation.

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[1] The Committee on Payment and Market Infrastructures (CPMI) of the Bank of International settlements and the Technical Committee of the International Organization of Securities Commissions (IOSCO) together set international standards related to the risk-management, efficiency and transparency of systemically important financial market infrastructures.

[2] More details on the Principles for Financial Market Infrastructures [PDF 1.06 MB]

[3] These include credit union centrals, trust and loan companies, life insurance companies, securities dealers, cooperative credit associations, and money market mutual fund corporations,

[4] The full paper: Task Force for the Payments System Review [PDF 426 KB]

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