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The CBA<sup>1</sup> is pleased to provide our comments on the Department of Finance's consultation on the review of the *Canadian Payments Act* (the "Act"). While the consultation is prompted by the requirement to review the Act since previous legislative changes took effect in 2015, the work being done by Payments Canada to modernize Canada's payment system makes this review particularly critical and timely. As the payments ecosystem is transformed and evolves, Payments Canada's duties and powers, and the legislative framework on which these are based, must also continue to evolve based on the objectives of safety and soundness, efficiency, and promoting user interests.

Consistent with the topics included in Finance's consultation paper, the comments that follow address whether the governance changes enacted in 2015 have been successful. In addition, we address questions raised in the consultation about membership eligibility and how best to adapt Payments Canada's membership structure to enable access to the core clearing and settlement systems. Finally, as part of Finance's review of the Act, we believe attention is needed to deal with new types of risks and liabilities that arise from Payments Canada's modernization plan.

### **Payments Canada Governance**

#### **Consultation questions:**

- 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?*

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<sup>1</sup> The Canadian Bankers Association is the voice of more than 60 domestic and foreign banks that help drive Canada's economic growth and prosperity. The CBA advocates for public policies that contribute to a sound, thriving banking system to ensure Canadians can succeed in their financial goals. [www.cba.ca](http://www.cba.ca).

When changes were made to the Act in 2015, Payments Canada's governance structure was changed to promote independent decision-making and strengthen public and government accountability. As a result of these changes, decisions became vested in the majority-independent Board of Directors. This included decisions on budgets and capital decisions, new activities, the organization's corporate plan, as well as amending or creating by-laws and rules. With the new Board structure, the Member Advisory Council was created so that member financial institutions would have input on key issues and decisions.

We continue to support principles of good governance and having a Board structure in place that allows Payments Canada's Board to work effectively. Good governance requires that boards carry out their fiduciary responsibilities by acting in the best interests of the company or organization as a whole, consistent with the duty of care obligations on directors in section 16.1 of the Act. As the OECD's Principles of Corporate Governance note,<sup>2</sup> the fiduciary duty of directors entails being accountable and having regard for the interests of stakeholders and their contribution to the long-term success and performance of the organization.

Many commentators on board governance discuss the impact of the communication and information gap between a board and management. There is also a fair amount of academic evidence<sup>3</sup> articulating the more effective business results arising from direct engagement between shareholders and boards.

Under the current Act, Payments Canada is fully funded by its members and banks are required to be members. This means members are directly impacted by Payments Canada's investment decisions but are unable to control their financial exposure. Members also bear the liability for actions that expose Payments Canada to increased risk, as well as claims made against Payments Canada (which we discuss later in our letter). Consequently, the need for member input on significant issues is magnified.

Section 5(2) of the Act currently stipulates that Payments Canada has a duty to take into account the interests of its users, and we feel this needs to be revised to expressly require members' interests to be taken into account. From our perspective, further changes to the Act are also needed so that Payments Canada's members are afforded greater input and participation in major Board decisions, especially on initiatives for which they will incur risks and liabilities. Similarly, a more rigorous process is needed to communicate feedback to members on the outcomes of Board decisions and reasons for choices made.

We believe the Act should set out a formal mechanism for Payments Canada to obtain input from its members on material decisions, and to heed the input received to ensure the organization is more accountable to its members in a manner that reflects capital and other contributions made. One of the mechanisms we propose is to require Payments Canada's

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<sup>2</sup> OECD (2015), G20/OECD Principles of Corporate Governance, OECD Publishing, Paris, pp. 34.  
<http://dx.doi.org/10.1787/9789264236882-en>

<sup>3</sup> Craig Doidge, Alexander Dyck, Hamed Mahmudi, and Aazam Virani; "Can Institutional Investors Improve Corporate Governance Through Collective Action?"; September 2015  
[http://www-2.rotman.utoronto.ca/facbios/file/DYCK-doidge-mahmudi-virani\\_Can%20Institutional%20Investors%20Improve%20Corporate%20Governance.pdf](http://www-2.rotman.utoronto.ca/facbios/file/DYCK-doidge-mahmudi-virani_Can%20Institutional%20Investors%20Improve%20Corporate%20Governance.pdf)

Board to solicit a report and recommendation from the Member Advisory Council in advance of major capital decisions; finalizing the organization's annual budgets and five-year corporate plans; and approving amended or new by-laws and rules. This is not intended to be a substitute for decision-making by the Board; rather, the expectation is for this more formal process to ensure members' feedback is clearly communicated directly to the Board. The Board should also be required to consider members' feedback and provide written justification when decisions are not aligned with members' views.

In addition, we believe the Act should set out an escalation or appeal process to the Minister of Finance for members to be able to seek reconsideration of decisions by Payments Canada -- particularly if they result in Payments Canada's members taking on risks or liabilities that go beyond their risk appetite. This mechanism could be drafted to specify in regulations the required majority that is necessary to appeal a decision. Having an escalation process would go a long way towards strengthening accountability and ensuring Payments Canada's decisions are aligned with the interests of its members. This mechanism would be an important governance mechanism to ensure member interests are appropriately considered.

## **Membership**

Consultation questions:

- 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. 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?*

The banking industry supports the objective of risk-based access to Payments Canada's systems for qualifying entities. Healthy competition in payments is the catalyst for innovation, leading to better payment products and services and improved convenience for end users. Maximizing value for end users and creating a thriving payments ecosystem are at the core of how we believe we should design and implement Canada's payment systems for the future.

To facilitate access to the Real-time Rail ("RTR"), the consultation paper proposes that a new associate membership class be created that would allow eligible payment service providers to exchange and settle payment items, subject to meeting additional requirements set by Payments Canada and the Bank of Canada for direct exchange and direct settlement, respectively. The consultation paper notes that the intent of this approach is to create a new class of members that is separate and distinct from existing members, with a separate set of rights and obligations.

In general, we support the model that Finance is proposing and agree that the rights and obligations of members participating in Payments Canada's systems should vary according to the risks inherent in each system, and considerations of safety and soundness. However, greater clarity is needed on how the various rights and obligations of associate members will be distinguished throughout the Act, by-laws, and rules. From our perspective, associate members that only participate in the RTR should not be represented on the Board, unlike full classes of members who are the heaviest users of the systems and incur the largest costs and liabilities. It would make sense, however, to make associate members eligible for a single, collective seat on the Member Advisory Council, so that their views are considered in Payments Canada's decision-making process. As noted earlier, ensuring the Board obtains the views of the Member Advisory Council would support the Board's obligation to consider the interests of its various members.

With respect to question #2 above, we strongly concur that registration and regulation under the proposed retail payments oversight framework are pre-conditions for the creation of this new associate membership class and for allowing associate members to participate and access Payments Canada's retail systems. More specifically, it is our view that broadened membership and access to payment systems can only be enabled when the framework is in place. The framework is essential for the safety and soundness of the payments system and protection of end users, as well as buffering the financial sector against risks and liabilities. In this respect, new measures will also need to be established under the Act for purposes of suspending or terminating membership and participation rights for associate members who are not compliant with the framework.

As the CBA noted in response to the government's previous consultation on its proposed retail payments oversight framework, a practical licensing and supervisory model under the framework should set out minimum standards related to financial, operational, and technical performance, as well as various market conduct rules and consumer protection requirements. Such standards must be in place under the framework to ensure that payment service providers eligible for access to Payments Canada's systems can fulfil their obligations to Payments Canada and other participants on a timely basis, along with addressing the other important aspects detailed in the CBA's comments.

Regarding participation in the Settlement Optimization Engine ("SOE"), the consultation paper notes that "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." It was understood when banks implemented the ACSS Interim Credit Model that the loss-sharing arrangement would be revisited as part of SOE design. We believe more study is required on whether mechanisms are needed for financial contributions by exchange-only participants in a default scenario.

In response to the final question regarding eligibility for direct access to Lynx, we generally support including financial market infrastructures ("FMIs") in the list of entitled members under section 4 (2) of the Act (other than LVTS or Lynx), insofar as they have been designated by the Bank of Canada as systemically important to Canada's financial system and subject to the Bank of Canada's oversight. Our expectation is these FMIs would need to meet the same participation requirements as other members participating in Lynx, including pledging collateral

to the Bank of Canada and making default contributions pursuant to that system's financial risk model. Given Lynx's systemic importance and the need to maintain safety and soundness, access must be limited to participants that meet high risk management standards.

Before FMI access to Lynx is implemented, further stakeholder consultation and expert analysis will be required to fully understand this proposal and how it should be structured. Issues to be considered as part of this analysis should include the location where each FMI (e.g., CLS Bank) would manage their daily Lynx payment activities; which jurisdiction would govern their record-keeping and resolution; whether there should be additional due diligence requirements; and whether any FMI would use the Bank of Canada for contingency purposes (similar to existing members).

### **Controlling Risk and Liability**

A number of proposals and initiatives that Payments Canada is pursuing as part of the modernization program will introduce new risks and liabilities for Payments Canada's members. This includes a financial liability to Payments Canada to defray the costs of new investments and undertakings, but also includes greater legal and financial liability associated with expanding access to Payments Canada's systems and increasing the volume and sensitivity of data flowing through its systems – particularly with the adoption of ISO 20022. Under the current legislative scheme, the financial costs and liabilities associated with these increased risks would ultimately be borne by Payments Canada's members and put member banks in conflict with their risk management and corporate governance obligations.

Where value-added services, shared utilities, and other functions are not central to Payments Canada's mandate, our view is that such functions should not be delivered by Payments Canada. At a minimum, we strongly recommend that provisions be added to the Act to ensure that risks resulting from these changes are appropriately contained, rather than diffused through the financial system.

### **Statutory Review**

The government's review of the *Canadian Payments Act* is a valuable opportunity to assess how well the legislative framework is functioning and whether it is keeping pace with the changes in the fast-moving payments ecosystem. Given that payments modernization is a multi-year initiative that will have significant implications for Payments Canada and its members, we recommend another review in the next three or four years be codified in the Act to reassess whether the objectives of safety and soundness, efficiency, and user interests continue to be balanced and calibrated.

We appreciate having the opportunity to contribute to this consultation process. Please feel free to contact me if you would like to discuss any of the topics contained in this letter.

Sincerely,

