Canadian Credit Union Association
151 Yonge Street, Suite 1000, Toronto, ON Canada M5C 2W7
T 416 232 1262 / 1 800 649 0222 E inquiries@ccua.com

Central 1 Credit Union
1441 Creekside Drive, Vancouver, BC Canada V6J 4S7
T 604 734 2511 / 1 800 661 6813 E info@central1.com

Central 1 Credit Union and the Canadian Credit Union Association's Response to the Department of Finance's Consultation on the Review of the Canadian Payments Act, July 2018

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Canadian Credit Union Association
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central 1
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Introduction

This submission is Central 1 Credit Union's ("Central 1") and the Canadian Credit Union Association's (CCUA) joint response on behalf of the credit union system to the Department of Finance's 2018 Consultation on the Review of the *Canadian Payments Act*. While other credit union system entities may provide independent submissions to this consultation, we have made every effort to obtain consensus on the views expressed in this response. For the remainder of this submission, except where appropriate, we will use the pronoun "we" to reflect the joint and collaborative nature of this submission. We consent to disclosure of our submission in whole.

Central 1, in its role as Group Clearer[1] for the national credit union system, facilitates the clearing and settlement of payment transactions between provincial credit union systems and counterparties in Canada and the United States. Central 1 is an integral part of the Canada's banking system, processing more than 300 million payments annually on behalf of Canadian credit unions outside of Quebec.

CCUA is the national trade association for 257 Canadian credit unions and caisses populaires outside Quebec that collectively control over $220 billion in assets and serve almost 5.7 million member/owners through 1,800 locations. CCUA's membership also includes provincial centrals and affiliated credit union entities such as Concentra Bank.

The Payments Modernization initiative holds many opportunities for growth and innovation and in our view, remains directionally appropriate for the Canadian payments industry. Furthermore, payments modernization has the potential to create efficiencies and strengthen the services we provide for our members and broader customer base. Working with Payments Canada to build a sustainable and responsive payments network is one of Central 1's strategic priorities.

However, the modernization project also holds possible long-term implications for stakeholders and consequently, it is very important to the credit union system that any potential for "unintended consequences" be considered in advance and mitigated to the greatest extent possible. And while Payments Canada has released a series of high-level plans and consulted with numerous stakeholders, there remains considerable uncertainty about what exactly will change, the timelines for development and transition to new systems, and the implementation cost for both Payments Canada and network participants.

It is Central 1's and CCUA's goal to ensure credit union interests are understood and considered throughout the payments modernization process and that credit unions maintain their ability to remain competitive as they respond to the rapidly changing retail and payments environment. To that end, we will be following up with the Department of Finance to pursue the idea, discussed at a meeting with officials in mid-July, about setting up a working group to discuss credit union-specific issues.

[1] The Group Clearer consists of Central 1 Credit Union, Credit Union Central of Alberta, SaskCentral and Credit Union Central of Manitoba.

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We would like to thank the Department of Finance for the opportunity to provide input on the consultation paper and look forward to working with the Department of Finance to ensure that the Canadian payments ecosystem meets the needs of Canadians and financial institutions.

Observations

The May 25 consultation paper on the review of the *Canadian Payments Act* seeks comments on two broad themes, Payments Canada's governance and options for broadening membership.

Payments Canada's governance structure was significantly revised in 2015 affecting all members and this consultation seeks feedback on the efficacy of those changes. In contrast, Payments Canada's membership framework has remained largely unchanged, at least with respect to the credit union system since the mid-1980s when the Act was first written. The proposal for a new "Associate Member" category, although not specifically aimed at credit unions, offers our sector a rare opportunity to directly participate in the payments system outside the strict membership criteria outlined in section 4(2)(a)1 of the Act.

While participation under the current Group Clearing concept has been, and will continue to be, essential to the credit union system, some credit unions may also wish to have the ability to act independently of their peers in certain instances should their business strategy and circumstances support it. It is from this perspective that we make our remarks

Consultation Questions

Governance

With respect to changes made to the Payments Canada governance framework in 2015, the Department of Finance has posed the following 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?*

Generally, we support the governance changes to Payments Canada. However, the most obvious consequence of the shift to a majority independent Board has been that representation by Payments Canada members (e.g. the banks, credit union Centrals) has been reduced, and collaboration between Payments Canada and its members instead relegated to other committees and working groups, such as the Member Advisory Council (MAC).

We therefore recommend that the Department of Finance modify the *Canadian Payments Act* and associated by-laws to ensure representation from credit union sector and, failing that, the co-operative banking sector. Given that more than 10 million Canadians rely on co-operative banking institutions (Desjardins + credit unions) for their financial services, alongside the government's objective to foster greater competition in the financial services space, we recommend that the Payments Canada board ensure appropriate representation.

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Co-operative banking institution representation on the Payments Canada's board ensures that an alternative financial institution (i.e., non-bank) perspective is considered during the Board's deliberations. As co-operatives owned by their members, the credit union/caisse perspective is grounded in the interests of its end users. This diversity of thought and representation at the board level will add value to Payments Canada's governance.

Additionally, we support the idea of having the board appoint Payments Canada members to a Member Advisory Council. Due to the proportion of Canadians that the credit union/caisse system represents, we recommend continued credit union representation on the Member Advisory Council to ensure diversity of thought, unique perspective, and consideration of the credit union system's needs.

Furthermore, we recommend that the Member Advisory Council have a seat on the Payments Canada Board and that this be a legislated requirement. This will generate alignment between the views of the MAC and broader Payments Canada members.

Lastly, Central 1 and CCUA support the addition of the review clause in 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. The payments landscape is changing rapidly, and the Act should be reviewed at least every three years so that appropriate legislative amendments can be made to enable market participants to adjust their strategies and plans to changing market forces.

A Payments Canada Associate Membership Class

With respect to the changes in Payments Canada membership, the Department of Finance posed three questions:

1. *Should the Government create an associate membership class to facilitate access to the Real Time Rail (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?*

Associate Membership

An Associate Membership Class

If access to the RTR is to be broadened beyond Payments Canada's current membership, but remain risk-based, it seems reasonable to create a separate and distinct membership class that is required to meet similar standards, albeit perhaps not to the same level of rigor required of existing "full" Payments Canada members since the RTR will be entirely pre-funded. As well, the notion that such membership be application-based is consistent with existing Payments Canada membership practices.

As Payment Service Providers (PSPs) under the retail payments oversight framework, it is our understanding that credit unions are envisioned as being eligible for Associate Membership. However, the current restriction imposed by section 4(2)(a) of the Act preventing "locals that are members of a central or a cooperative credit association" from membership in Payments Canada, suggests that credit

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unions could inadvertently be excluded from becoming "Associate Members" due to the unqualified nature of this prohibition. Additional clarity on this point would be appreciated.

Credit unions are looking for flexibility and participation alternatives for the RTR that may allow them to compete effectively against much larger players in this evolving space. It is our understanding that while various RTR participation options will become available under the proposals, including direct participation, a credit union that is an Associate Member would still need the services of a LVTS/Lynx Participant to effect settlement of RTR transactions on its behalf or effect the transfer of funds to its RTR settlement account at the Bank of Canada, should it choose to settle its RTR items directly. Importantly, regardless of the method of RTR settlement, the credit union would still need to maintain its connection to the Group Clearer to continue its participation in LVTS/Lynx and ACSS/SOE.

While there are undoubtedly some credit unions that will wish to explore the direct RTR participation option and Associate Member status, we do not believe the majority will want to pursue this route, if only due to the cost and resource demands of direct participation. Not only is the scale achieved through group clearing fundamental to credit union system efficiency and cost effectiveness in payments operations, but various system liquidity mechanisms have evolved with group clearing in mind.

Therefore, while we recognize the need for a framework that provides greater flexibility, we emphasize that the national group clearing arrangement provides essential economies of scale for credit unions and ultimately to the millions of Canadians they serve. The scale and resulting savings achieved through the group clearing structure are essential to the sector remaining competitive against existing and emerging competitors in the financial services industry. As a result, the group clearing construct needs to be included in the RTR's participation alternatives.

However, we do not believe that any reasonable analysis or assessment of the attractiveness and long-term viability of the Associate Member/direct RTR participation model to credit unions can be conducted until we have a clear articulation of eligibility/participation criteria for the RTR, the requirements for access to Bank of Canada settlement accounts, Payments Canada voting rights, funding model, etc. However, more information regarding the structure, qualification for membership, costs, and privileges and responsibilities associated with this membership class, and other operational details, are required before meaningful and decisive feedback can be provided.

We look forward to the Bank of Canada clarity on bank account access and ensuring it continues to meet the needs of Canadian credit unions.

<u>Recommendation</u>: That the amended membership framework provide flexibility for credit unions, including preserving their ability to continue with the group clearing framework.

Associate Member Fees and Dues

Central 1 and CCUA are in support of a modified funding model for fees and dues, with respect to the RTR, that is consistent with driving innovation on the RTR. Fundamentally, the funding model should allow participants to leverage the rail as best as possible and we concur with the Department of Finance that fees and dues should not create barriers to entry on the RTR. It is our understanding that additional consultation will occur regarding the RTR exchange fee model and look forward to participating in this effort.

Registration Under the Proposed Oversight Framework as a Precondition

The consultation paper makes a strong link between the new retail payments oversight framework and the ability to apply for Associate Membership in Payments Canada. In this regard, we would like to take this opportunity to reiterate that the interplay between the new proposed framework and existing provincial and federal ones needs to be clarified so that there is no duplication in obligations—and therefore no unjustified administrative burden—stemming from jurisdictional issues.

Avoiding unnecessary regulatory burden also shapes our thinking on registration under the new framework as a precondition for application as an Associate Member. As proposed, registration under the framework would be mandatory for all PSPs, and without successful registration, a PSP would not be eligible to apply for Associate Membership in Payments Canada.

While we agree that successful registration should be a pre-condition to a membership application process, we would like to highlight that an unqualified, antecedent requirement for registration would seem to be onerous and unnecessary for those PSPs that are already prudentially regulated and do not intend to seek Associate Membership in Payments Canada.

Our rationale for this is straightforward: the new retail payments oversight framework aims to foster trust by creating an environment for the largely unsupervised "non-traditional" PSPs that parallels that of "traditional" PSPs, many of whom function under robust deposit insurance and federal or provincial regulatory regimes and are already full members of Payments Canada. Registration is presumably intended to "level the field" and demonstrate that all PSPs meet certain prudential, operational, and market conduct standards—a necessary assurance to consumers, as well as, participants in the payments system.

Proposals under the new oversight framework would see all credit unions identified as PSPs and require them to register with its regulator. However, as deposit-taking financial institutions, credit unions are already held to a higher standard than other financial entities and meet, or even exceed, the benchmarks set out in the new framework. And recent efforts within the credit union system promise to even further strengthen this position with the development and adoption of a comprehensive, sector-driven, Market Code of Conduct. Therefore, the assurances registration seeks to provide to consumers are already in place and the new framework's requirements would be repetitive for credit unions.

With respect to assurances to other payments system participants, as previously noted and further detailed below, most credit unions will likely continue to clear as a group. The result is that while credit unions may meet the stated criteria for a "PSP", a requirement to register with the new regulator when a credit union only intends to operate under the Group Clearing umbrella imposes an unnecessary administrative burden. Instead, in this situation, registration requirements should fall only to the Group Clearing Centrals, as the only Payments Canada members in a group clearing context.

Recommendation: For those PSPs falling under provincial or federal regulatory schemes that satisfy the standards outlined in the retail payments oversight framework, only those entities that already hold, or

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intend to gain, Payments Canada membership should be required to register with the new regulator. For these PSPs, the intention to become a Payments Canada member should trigger the requirement to register with the new regulator.

Payments Canada Governance Specific to Associate Membership

We support Associate Members participating in the governance of Payments Canada provided that the matters being considered directly impact the associate members and that their participation be reflective and representative of their position relative to "full" Payments Canada members. We believe however that it would be unfair to provide associate members with the same voting powers as full members.

Associate Membership in relation to the SOE

As payments technology innovation continues in the years and decades ahead, it is conceivable that demand will emerge from Canada's financial institutions (including some credit unions) to engage with the SOE exchange network, either directly or indirectly. In such a quickly-evolving sector, it is challenging to predict exactly how this future development might take shape, and equally difficult to anticipate the unintended consequences that broader engagement with the SOE exchange network might bring. Legislation and related frameworks developed today must anticipate the need to adapt to this potential future demand. However, they should also embed a requirement for significant consultation and analysis on the impact such a change would have on the safety and stability of Canada's payments system.

Recommendation: Consideration be given to a) mechanisms by which entities meeting Payments Canada access criteria could engage in file exchange on SOE exchange networks; and, b) the impact analysis required, including consultation from key stakeholders, to safely incorporate such mechanisms.

Payments Canada Liability

Central 1, as Group Clearer for the credit union system supports the application of a "limited liability" concept for Payments Canada and its members that follows from the addition of the RTR. In its mandate to establish and operate the national systems, the role of Payments Canada must be clear. Central 1 and CCUA recommend including in the Act, language that specifically limits liability for Payments Canada and its members in the development, operation, and participation in Payments Canada systems.

While we appreciate the need for additional services and Payments Canada's potential opportunity to diversify its mandate, we see concern with the liability that could be taken on if Payments Canada's role extends into commercial activities. Furthermore, Central 1 and CCUA are particularly concerned that Payments Canada would be leaving its members vulnerable to bearing the liability for risks associated with commercial activities.

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Conclusion

We would like to thank the Department of Finance for the opportunity to provide feedback on this important consultation. As highlighted throughout our response, payments modernization has the potential to strengthen service and efficiencies for our members and broader customer base; however, payments modernization also entails significant complexities that could give rise to some unintended consequences.

While the RTR will optimize the way Canadians make payments, it may also pose challenges regarding credit union competitiveness in the payments ecosystem. And while we recognize the creation of an Associate Membership class to provide flexibility to qualified entities wanting direct access to the RTR, the group clearing structure must be preserved to ensure economies of scale and credit union savings. This will ensure credit unions across Canada remain competitive in the evolving financial services landscape.

We believe there are potential business opportunities associated with the restructuring of the Canadian payments industry. It is our goal to ensure credit union interests are understood and considered throughout the payments modernization process and that credit unions are poised to anticipate and respond to the changing retail and payments environment.

We look forward to working closely with the Department of Finance going forward to ensure new payments systems maximize benefits for both Canadians and credit unions and that regulatory frameworks balance the need for safety, access, and economic efficiency. We will again be reaching out shortly to set up a meeting to discuss the creation of a working group to achieve that objective.

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Appendix A – Summary of Recommendations

1. It is recommended the Department of Finance, in conjunction with Payments Canada, set up a working group to discuss credit union-specific issues in relation to the Payments Modernization initiative.
2. It is recommended that the Department of Finance modify the Canadian Payments Act and associated by-laws to ensure representation from credit union sector and, failing that, the co-operative banking sector.
3. It is recommended that there be continued credit union representation on the Member Advisory Council to ensure diversity of thought, unique perspective, and consideration of the credit union system's needs.
4. It is recommended that the Member Advisory Council have a seat on the Payments Canada Board and that this be a legislated requirement. This will generate alignment between the views of the MAC and broader Payments Canada members.
5. It is recommended that the amended membership framework provide flexibility for credit unions, including preserving their ability to continue with the group clearing framework.
6. It is recommended that consideration be given to:
    a. mechanisms by which entities meeting Payments Canada access criteria could engage in file exchange on SOE exchange networks; and,
    b. the impact analysis required, including consultation from key stakeholders, to safely incorporate such mechanisms.
7. It is recommended that for those PSPs falling under provincial or federal regulatory schemes that satisfy the standards outlined in the retail payments oversight framework, only those entities that already hold, or intend to gain, Payments Canada membership should be required to register with the new regulator.
8. It is recommended that the Department of Finance include in the Act, language that specifically limits liability for Payments Canada and its members in the development, operation, and participation in Payments Canada systems.