

July 27, 2018

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SENT VIA E-MAIL
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Re: Consultation on the Review of the *Canadian Payments Act*

Dear Leah:

Payments Canada welcomes this opportunity to provide feedback on the Department of Finance Canada's consultation on the review of the *Canadian Payments Act* (CP Act), published May 25th 2018, that seeks to assess the effectiveness of the 2015 governance changes and to ensure the necessary legislative framework is in place to position the organization for the future.

In fulfilling its legislative mandate and public policy objectives, Payments Canada strives to meet the needs of its members and the broader Canadian public interest. The governance changes made in 2015 have been instrumental to facilitating the transformation of the organization and initiating the modernization of Canada's core payments infrastructure and that of many of the members.

The public purpose role of Payments Canada has always involved a tension between private and public interests. With the introduction of the new governance structure, and the organization's ambitious Modernization program, this tension is even more prominent. But our experience thus far has been that the strong corporate governance mechanisms put in place in 2015 have supported a healthy and informed debate with our members and stakeholders on priority objectives, and have enabled us to set in motion actions to achieve them. Going forward, Payments Canada is committed to continue working to ensure transparency and accountability, and maintain the full confidence of members, stakeholders and regulators.

As the payments ecosystem evolves, we continue to play a core role in operating essential infrastructure and setting rules and standards for payments in Canada. We have also since 2015 increased our efforts to fulfill the innovation aspect of our mandate.

Payments Canada needs a legislative framework that allows the organization to remain highly effective and to lead change within the ecosystem. This includes introducing a new real time rail capability, providing new access opportunities to regulated entities that wish to use our systems and

benefit from their robust rules and legal frameworks and, in the process, spurring innovation in the marketplace.

We would like to acknowledge the open and collaborative approach that Finance Canada has taken in initiating its review of our enabling legislation, with Payments Canada, our members and stakeholders in the payments ecosystem. We are confident that this approach will result in high quality outcomes that enjoy broad-based support. We remain committed to working with Finance Canada as it completes its review and prepares for the legislative and regulatory processes to follow.

Sincerely,



Gerry Gaetz
President and Chief Executive Officer
Payments Canada

PART 1: Overview

Payments Canada is a public purpose entity comprised of required and eligible members, established by the *Canadian Payments Act (CP Act)* and regulated by the Minister of Finance and the Bank of Canada. As an organization, we underpin the Canadian financial system and economy by owning and operating Canada's payment clearing and settlement infrastructure, including associated systems, by-laws, rules and standards. In 2017, Payments Canada cleared and settled transactions totaling \$50.45 trillion, averaging \$199.39 billion each business day.

A modern, flexible and robust policy and legal framework is critical for Payments Canada. This framework begins with a strong statutory foundation, including the *CP Act* and the *Payments Clearing and Settlement Act (PCSA)*. Under the *CP Act*, Payments Canada is accountable to the Minister of Finance, and its core payment systems are overseen by the Bank of Canada in accordance with the *PCSA*.

Payments Canada is guided by its legislated mandate and public policy objectives as outlined in the *CP Act*. The objectives are to establish and operate national systems for the clearing and settlement of payments; to facilitate the interaction of its clearing and settlement systems with other systems; and to facilitate the development of new payment methods and technologies. In pursuing this mandate, Payments Canada must promote the public policy objectives of efficiency, and safety and soundness of its clearing and settlement systems and take into account the interests of users. As we work to support the federal government's achievement of its broad public policy objectives, we continually strive to provide world class service and value to our member institutions.

Context

The government's review of the *CP Act* comes at a key inflection point in the organization's history and in the evolution of the retail payments ecosystem. In furtherance of its mandate and public policy objectives, Payments Canada is leading an ambitious industry Modernization program. Under its new governance structure and the cooperation of its financial institution members, Payments Canada will replace its two legacy payments clearing and settlement systems with three new systems to operate high value, batch retail and real-time retail payments for Canada. These systems will be underpinned by modern and more flexible policy and legal frameworks.

The review of the *CP Act* has implications for competition and innovation in the payments marketplace. A key component of the Modernization program is to facilitate more open, risk-based access to the core payments clearing and settlement infrastructure in Canada, consistent with

international standards and policy direction from Finance Canada and the Bank of Canada. Payments Canada has been consulting with members and stakeholders on access proposals that take into account the distinct purposes of each of the payment systems. The proposals under consideration have been guided by regulatory expectations for fair, open, and risk-based access, while ensuring the efficiency and safety and soundness of our clearing and settlement systems, and taking into account the interests of users.

Payments Canada has a role to play in defining eligibility to directly participate in its systems; however, the ultimate arbiter of participation is Parliament, through the determination of Payments Canada's membership. The Bank of Canada also plays an important role defining access by setting criteria and requirements for settlement accounts and loan facilities, which enable settlement in Payments Canada's systems. When considering the federal government's planned introduction of a retail payments oversight framework, our Modernization effort and related access review can support the Government of Canada's efforts to enhance, over time, the participation of non-traditional players in the core payments clearing and settlement infrastructure.

PART II: Governance

In June 2015, amendments to the *CP Act* came into effect, marking the first substantive changes to the Act since 2001. The focus was on the governance structure and new accountability requirements. The changes, along with those made to the PCSA, were intended to strengthen the governance and oversight of the Canadian payments sector and to ensure that the national clearing and settlement infrastructure was being operated for the benefit of Canadian consumers and businesses.

Consultation Question: 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?

It has been three years since the governance changes took effect, and they are helping achieve the government's public policy objectives and supporting the effectiveness of Payments Canada. The Modernization program, the most ambitious in our history, is the most obvious example of how Payments Canada, under its new governance arrangements, is seeking to fulfill its public purpose for the betterment of Canadians. Other evidence includes:

- *Transformation & building capacity:* Since 2015, Payments Canada has transformed its operations, support functions, people and culture, building the organizational capacity to be a world class financial market infrastructure. Internal capacity has been bolstered across the organization, from operations, to risk, security, legal, policy and research. The introduction of an Enterprise Risk Management Program, a new leadership team, and an updated approach to financial management are augmenting robust processes and establishing Payments Canada as a best-in-class benchmark.
- *Delivering key initiatives towards the long-term desired outcomes in our Corporate Plan:* Key Modernization milestones include the development and 2018 delivery of a new credit risk model for the ACSS and the on-track delivery later this year of enhancements to Automated Funds Transfer (AFT) services (additional intra-day exchanges and faster funds availability via standardized requirements). Meeting the Bank of Canada's systemically important system standards for the LVTS in 2017 was a significant achievement towards our regulatory requirements and payments system resiliency was bolstered through the successful delivery of the Disaster Recovery Enhancement project and the Cyber Security project. These are just a few highlights from the full report of achievements in the annual Corporate Plan.
- *Meeting reporting requirements and ensuring public transparency/accountability:* The Minister of Finance approved the 2016 and 2017 Corporate Plans, and Payments Canada has adopted a policy of publishing the full report (exceeding our mandated reporting requirement) in order to increase transparency and public accountability.
- *Effective member engagement (introduction of MAC):* Since 2015, the 20-person Council was formed and has provided important input and advice on a number of Modernization issues, including regular written and in person reports to the board and accompanying Payments Canada's annual report.
- *Effective stakeholder engagement (via the Stakeholder Advisory Council (SAC)):* The SAC continues to have an important advisory voice both at the management and board level and makes regular written and in person reports to the board and accompanying our annual report. Collaboration between the SAC and MAC that began in 2017 (including joint workshops) has continued into 2018, serving to build understanding and goodwill while providing critical input to Payments Canada's work.

In addition to these indicators, Payments Canada regularly surveys its members and stakeholders, and conducts regular financial, technology and security audits, with strong results.

The 2015 legislative changes have prompted the implementation of practices and procedures that support effective governance and decision-making. This includes, a robust annual board self-assessment, which results in action plans for continuous improvement; and governance and nominating committee oversight of the MAC, SAC and board recruiting and nominating process, aimed at ensuring the board of directors has the necessary diversity and depth of skills, expertise and experience that it considers necessary to carry out its responsibilities, both at the board and its advisory councils.

Under the new governance structure, Payments Canada's board consists of five member directors, seven independent directors and the President and CEO of Payments Canada. Board members are elected at the Annual General Meeting (AGM), to which members are invited to attend in person to vote and to raise issues with management and the board. Experience since 2015 has been that the board of directors has been a place of healthy debate, and that decisions have had consensus support of both independent and member directors. Members are provided with notice and an opportunity to attend the AGM to vote and ask questions or raise issues. No members have raised issues or concerns at the AGM.

Consultation Question: 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?

Targeted Recommendations

As Payments Canada gains greater experience with the new governance arrangements set out in the *CP Act*, we are seeking to support an open dialogue on how they are working. We also continue to review and assess how, through governance-related processes, we can ensure and enhance transparency and accountability to members, stakeholders and regulators. Effective governance requires active support, diligence, and the willingness to change and address concerns that can undermine confidence and support.

Based on experience over the past few years, Payments Canada has identified some areas where changes would support enhanced governance and effectiveness. These are:

- *Revising the stipulations for director and chair terms:* The current legislated term requirements are rigid. They have impeded some efforts to appropriately stagger director

turnover and manage succession; and, looking ahead, too-frequent turnover can have a disruptive impact on board operations and present risks at the strategic level. The onboarding of new independent directors (who often require significant orientation and education about the payments ecosystem) also presents a significant effort. Introducing more flexibility and the potential for longer service on the board would help address these issues. Specifically, we recommend maintaining the three year term for Elected Directors while extending the maximum service to ten years (introducing the option of a short final renewal¹); and extending the Chairperson and Deputy Chairperson to a term not exceeding three years, the term being renewable. These are consistent with best practices among similar organizations and would allow for flexible planning on board succession, ensuring there is sufficient knowledge on the board and providing greater options to manage potential knowledge gaps in situations where a director leaves early or to provide continuity of oversight for the duration of a lengthy, critical project.

- *Adjusting the level of prescription on SAC provisions in the Act:* The Stakeholder Advisory Council has long been the key vehicle for Payments Canada and its board to leverage the advice of payments system stakeholders and end users. We want to ensure SAC retains a strong legal foundation but also that the council is effective and can evolve in step with the payments ecosystem. We recommend that the current level of prescription within the *CP Act* regarding SAC be reviewed, with an eye to leveraging other tools (e.g., by-laws and Terms of Reference) where appropriate to achieve policy outcomes. Having less prescription in the Act will give Payments Canada greater flexibility to make necessary changes to SAC's structure and roll over time, including as our membership evolves. At the same time, maintaining key SAC provisions in Payments Canada by-laws (which are statutory instruments under the Statutory Instruments Act) will ensure ministerial oversight and a strong legal foundation. The size of the council, terms of members and chairperson, and remuneration (see following) are provisions that should be moved to a by-law or terms of reference, and the placement of similar provisions governing MAC provides a useful precedent to consider.
- *Removing the prohibition on remuneration of SAC members (Section 21.2 (7)):* While we understand this clause was intended to promote SAC member independence, a blanket prohibition on remuneration has limited Payments Canada's ability to fulfil certain SAC

¹ Common practice with variable terms is to adopt a set term that applies for all directors (e.g., three years); however, the option for a shorter term (e.g., one year) is available if needed (e.g., for knowledge transfer, continuity through a big project, etc.).

composition requirements, principally in the consumer representation space. Having greater flexibility to develop and employ a transparent remuneration policy would help ensure we can meet our composition requirements and attract the appropriate consumer expertise on the Council. In addition, the prohibition contradicts section 18(1)(k)(ii) of the *CP Act*, which provides the board with the authority to make by-laws respecting the remuneration of SAC members.

- *Reviewing key terminology:* In the course of our analysis to modernize the access frameworks for Payments Canada systems, we have been reminded that some participation-related terminology in the *CP Act*² dates back decades to an era of paper-based payment items. We recommend that this be reviewed to ensure that participation frameworks are clear and robust as the trend to electronic payments continues.
- *The inclusion of an ongoing/regular review clause in the Act:* A provision causing the Act to be reviewed every five years would allow for a regular opportunity to evaluate how the Act is serving its purpose as the payments landscape continues to evolve. A regular review is particularly pertinent given the materiality of the proposed changes to the membership structure and the pace of industry developments, both in Canada and around the world. It is also consistent with common practice for other federal financial sector legislation.
- *Change the corporate name “Canadian Payments Association” to “Payments Canada:”* Updating the legislation with the organization’s branded name would help solidify Payments Canada’s public purpose role in the payments ecosystem, as well as its transformation and new identity in a rapidly changing payments marketplace. We recommend that this be achieved in a way that would effectively “grandfather” existing legal material that refers to “Canadian Payments Association,” minimizing administrative impact on members and other entities.

Payments Canada looks forward to continued collaboration with Finance Canada in order to facilitate the finalization of recommended legislative changes in these areas.

² Principally, in Section 29, the rights of members include, ‘Members may present payment items and shall accept and arrange for settlement of payment items in accordance with the by-laws and the rules’.

Funding and Liability

We are confident that the overall framework introduced in 2015 will support the success of the organization over the medium-term, however, changes in membership/participation in core systems and additions to our operator role (e.g., adding the Real Time Rail) require us to ensure that risk, liability and funding are modified appropriately. More specifically, we are seeing increasing questions about the sustainability of a model whereby a majority independent board has the financial and operational decision-making authority, but members fund the activities of the Organization. The 2015 *CP Act* amendments changed the governance of Payments Canada, including authority for budget approval (previously by members, now approved by the board with a requirement to consult with members). Management now consults with members annually on its budget plans before seeking board approval, and this process is timed to align with members' own budget planning cycle. Members are consulted on all strategic issues and major capital investments (e.g., on all key aspects of the Modernization program) and are informed regularly of the activities of the organization through the Member Advisory Council (MAC), which reports to and advises the board on matters of interest to the membership. The 2015 amendments also require Payments Canada to submit annually a corporate plan for approval by the Minister of Finance. However, the amendments did not affect the "member association" model set out in the legislation when the organization was first created in 1980 with a member control-based board.

Under the current legislation, Payments Canada has restricted authority to limit its liability, and that of its members, in the exercise of its statutory objectives.³ This legislative restriction may need to be changed as a result of a broadening of membership and participation in Payments Canada systems. Payments Canada understands that there are important public policy issues to consider, and deeper research and dialogue between industry and regulators is required.

PART III: Membership

General Comments

Payments Canada membership is an important policy tool for the Government of Canada to promote competition and also preserve the stability of the national clearing and settlement systems, only Payments Canada members may participate in our systems. When the organization was created in

³ The board has the power, via by-laws, to limit the liability of the Association for any loss suffered by a member, however this power does not extend to losses suffered by a non-member (e.g., end user).

1980, membership was limited to prudentially-regulated deposit-taking institutions (i.e., banks and credit unions), providing all deposit-taking financial institutions in Canada with the opportunity to participate directly in the clearing and settlement of payments. The membership arrangements for Payments Canada have only been changed once since then, when in 2001 a new membership category of eligible members (including, e.g., life insurance companies and securities dealers) was created.

As Finance Canada considers a new round of changes to our membership framework, we would highlight the important legal, policy and operational implications of any change, and encourage continued consultation with Payments Canada members and stakeholders. In particular, any membership changes must be considered in the context of Payments Canada board structure, advisory council arrangements, financial and legal liability structures, and in relation to rights and obligations for participation in Payments Canada systems.

While any changes to Payments Canada's membership structure will have implications, we expect that most of the impact will be in Payments Canada by-laws, regulations and rules. We recommend that Finance Canada consider the dual goals of flexibility and legal certainty when reviewing the provisions of the *CP Act*. The *CP Act* should provide a flexible enabling framework, allowing for detailed provisions to be articulated in regulations and by-laws (which are still subject to oversight by the Minister of Finance).

However, flexibility should not come at the expense of creating legal uncertainty. First, Finance Canada should review the *CP Act* with a view to being explicit in which member classes are comprehended in each reference to membership and members, including with respect to MAC. Second, it will be very important that the board's by-law making powers under Section 18 apply to associate members (e.g., penalties for non-compliance).

We would also call out that the level of participation by our membership affects the ubiquity and efficiency of the national payments clearing and settlement infrastructure, with associated implications for financial sector safety and soundness, but also end-user interests. The success of Canada's Real Time Rail will be contingent on broad adoption and ubiquity of payment exchange: from an end-user perspective, it will be imperative that entities from across the ecosystem participate to allow the movement of funds between accounts. As an organization mandated to operate national systems and facilitate new payment methods and technologies, we continue to evaluate how the benefits members enjoy equate to their obligations, and what tools are appropriate for the organization to have to facilitate positive public policy outcomes, whether it be the adoption of ISO message standards or the adoption of new payments clearing and settlement infrastructure.

Funding

Payments Canada funding is another area that requires careful consideration. The funding model, as laid out in By-law No.2 (Finance), is both dues and transaction-based, with the majority of budget funding (about ninety per cent) derived from member use of the systems, based on transaction volumes. The balance comes from common service dues paid equally by all members, which ensures an amount is recouped from all members who enjoy common services of the organization. A key feature of the current funding model is fairness, in ensuring a minimum of fees are collected from all members, so individual members cover the cost of the services they use.

While incorporating associate members in the funding structure could lead to by-law changes, we would highlight that Payments Canada's ability to charge member dues is set out in the *CP Act*. It will be very important for the power to charge dues to be extended to include associate members, in order to allow sufficient flexibility to determine an appropriate funding model.

The Cooperative Sector

In the course of the review, Finance Canada should also consider whether the current prohibition on membership for locals that are members of a central or cooperative credit association⁴ remain appropriate. The Canadian cooperative sector has evolved significantly since this restriction was established. It has seen considerable consolidation and bifurcation, resulting in significantly fewer credit unions and a small group of credit unions becoming larger. The clearing and settlement relationships and processes have also evolved as well as the regulatory landscape, including a transition from federal regulation of the centrals to provincial oversight. In light of these changes and with consideration being given to more open, risk-based access opportunities, an opportunity exists to carefully think about how the cooperative sector participates in Payments Canada's systems. While these entities may perform similar functions to a non-financial institution payment service provider (PSP) who might be defined within the associate membership category, they operate within a distinct regulatory environment that should be recognized and carefully considered. As a guiding principle, the government should seek to provide a level playing field for PSPs of varying institutional form, taking into account their specific regulatory situations and their participation opportunities in Payments Canada systems.

⁴ *Canadian Payments Act*, section 4 (2) (a).

Consultation Question: Should the Government create an Associate Membership class to facilitate access to the RTR? Should alternate approaches be considered?

Payments Canada is of the view that its membership structure can be modernized to meet the needs of the evolving Canadian payments ecosystem and enable more open risk-based access to our systems without compromising safety and soundness. Enhanced risk management frameworks (e.g., collateral requirements for the ACSS and a planned pre-funding settlement model for the RTR) and technology advancements are improving the overall risk profile of the systems. At the same time, non-traditional players have emerged, bringing efficiencies and improving competition at different stages of the payments value chain. Taken together, these factors provide opportunities for broader participation. Formalizing relationships with new players through membership provides certainty and clarity in roles, responsibilities and liability and is consistent with Payments Canada's compliance powers that only extend to members.

The realization of a new associate member category should be guided by the following principles and considerations:

- Membership should reflect the new risk management approach: Membership has always served as a key way to limit risks on systems. With modernized risk models and new oversight expectations that manage risk (e.g., collateral requirements for ACSS), technology advancements, and options in development to tailor participation requirements to functions and the related risks, we see it as feasible to open membership to other types of regulated entities.
- Membership needs to reflect changing roles and responsibilities in the new ecosystem: Non-traditional players have emerged, bringing efficiencies and improving competition within different stages of the payments value chain. This is causing a reconsideration of the way new players should interact with Payments Canada systems and members. The *CP Act* only provides Payments Canada with authority over its members. Formalizing relationships with new players through membership provides certainty and clarity in roles, responsibilities and liability. Expanding our membership would also support our ongoing role in developing and deploying payments-related standards (e.g., ISO messages) for ecosystem adoption.
- Membership should serve to facilitate open and risk-based access to the new systems: Participation in Payments Canada's systems is conceived of in the concept of membership

(i.e., only Payments Canada members may participate in the systems). More open, risk-based access can only be enabled through legislative change regarding membership. Risk-based participation requirements should also be set out in regulations, by-laws, rules and user agreements.

- The membership structure should be designed with an eye to the future evolution of the systems. The systems are being built to allow for innovative new capabilities and services to be added in response to regulatory developments, market needs, and demands for broader access. Effective placement of provisions in the *CP Act*, bylaws and regulations can be used to ensure appropriate flexibility to respond to evolution in the industry and the systems.

Consultation Question: Should registration and regulation under the proposed Retail Payments Oversight Framework be a precondition for Associate Membership?

As mentioned above, Payments Canada is confident that participation in our systems by non-financial institution PSPs can be facilitated through appropriate risk mitigation approaches. Regulatory oversight of our member institutions has been, and always will be, essential in safeguarding Payments Canada systems, the participants, their business partners and end users. This prudential and market conduct oversight serves as a primary risk mitigant, which is then bolstered with additional requirements developed and applied to system participants by Payments Canada (and the Bank of Canada in its role as settlement account provider).

In our view, registration and regulation under the proposed federal retail payments oversight framework, which aims to protect end users and mitigate risks in the retail payments space, is an essential precondition for associate membership eligibility. There are complexities and challenges associated with taking steps to establish a new membership framework and participation requirements for our new retail systems prior to having the retail oversight framework fully implemented. However, we look forward to collaborating with our regulators, members and stakeholders to chart the path forward.

Consultation Question: 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?

Payments Canada's membership is already very heterogeneous in terms of institution size, geography and market positioning, to name a few characteristics. We have also always sought to incorporate the diverse views of payment system stakeholders (e.g., consumers, corporates, PSPs, governments) into organizational decision-making. The addition of associate members will require some adjustment to how we currently balance these diverse voices and interests (including Member and Stakeholder Advisory Council roles and composition, board composition, etc.), and require careful consideration of how we should adapt over time to maintain legitimacy of the governance framework.

Striking the right balance in the governance structure will be critical. Providing end-users and new players an appropriate voice in decision-making and governance should be balanced with ensuring that members continue to have representation commensurate with their system usage and risk exposure.

Payments Canada is of the view that Finance Canada should consider how the existing governance structure can incorporate representation of associate members. This view is based on the practical consideration that we do not yet know how quickly an associate member class will be operationalized, how many entities will seek associate membership, and of those associate members, how many will become active participants on our systems. Evolution in the membership will take some time, and it would be prudent to gain some experience before taking active steps to reform key advisory and decision-making bodies.

For instance, in addition to providing for additional flexibility for the SAC to evolve over time (as recommended above), we would advise that Finance Canada review the MAC requirement that "the Council be broadly representative of the diversity of the membership of the Association." Clarity that this provision applies to both members and associate members would provide flexibility for the MAC composition to evolve without legislative change.

Once the federal Retail Payments Oversight Framework is in place and the new associate member class takes shape, a comprehensive review of governance arrangements should be conducted to determine what specific legislative or policy changes are warranted. Our recommendation for the introduction of a five year review clause in the *CP Act* would facilitate this.

Consultation Question: 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?

Along with Payments Canada, there are several other financial market infrastructures (FMIs) that have been designated by the Bank of Canada as systemically important under the PCSA, and that fall under the regulatory oversight of the Bank. These FMIs have arrangements with the Bank of Canada that allow them to indirectly leverage the functionality of the LVTS (using the Bank of Canada to participate and settle on their behalf). Done right, allowing designated FMIs to become direct participants in Lynx could support financial system efficiency, safety and soundness. We therefore support this policy direction in principle. Membership in Payments Canada would be a necessary precondition, and it is expected that that the same participation requirements, from both the Bank of Canada and Payments Canada, would need to be met. We are consulting stakeholders and members on the risk and policy implications of granting designated FMIs direct access to Lynx, including consideration on additional due diligence requirements, including related to cross-border operations. We look forward to working closely with Finance Canada and the Bank of Canada on the issue.