

Task Force for the Payments System Review

# Policy Paper C: Legislation

## Establishing the Payments Industry

December 2011

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# Policy Paper C: Legislation

## —Establishing the Payments Industry

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## Executive summary

Legislation will be needed to implement the governance model outlined in *Policy Paper B: Governance*. This legislation must reflect the principles upon which the model is based. Those principles include proportionate, risk-based regulation, where appropriate; an inclusive approach to industry self-governance; and an oversight mechanism to address unresolved issues and assert the public interest.

### *Existing legislation*

When payments were almost exclusively the domain of regulated financial institutions, public policy concerns could be addressed through the legislation governing these entities. Increasingly, however, payments services are being offered by other types of firms. As a result, new legislation focuses on the function performed, rather than on the type of institution. The *Payment Card Networks Act* is an example.

A review by the Regulatory Advisory Group identified only a few significant gaps in the current Canadian legislative regime, but the lack of an overarching legislative framework to provide coherence and responsiveness in dealing with a changing situation does not bode well for the future. One of the most important gaps means that newer players in the payments industry (PayPal, Zoompass, etc.) are subject to no oversight at all. Another is the current lack of transparency and clear disclosure regarding consumer risks and protections. Such problems will only increase as the Canadian payments system evolves.

### *A new approach*

The recommended approach would eliminate the need for specific new legislation to target undesirable practices or unregulated players. It would define, for the first time in Canada, the payments industry as a distinct sector and would spell out the way in which participants in the payments system would be identified. Further goals of the legislation would be to provide for a principles-based oversight function and to allow recognition of a self-governing organization (or more than one) to which authority can be delegated.

## 1. Defining the payments industry

The legislation would set out the criteria for subjecting an entity to the regime or not, according to the functions it performs in the payments system. A “payment service provider” would be defined in legislation as one that facilitates the transfer of monetary value from one party to another. How directly a firm’s activities relate to this function is what would determine whether it is a payment service provider for the purposes of the legislation.

When the Task Force’s Regulatory Advisory Group applied this approach, its findings were as follows:

- Traditional financial institutions, network operators, credit and debit card issuers and acquirers would be included, as would new participants such as online payment networks.
- Issuers of financial cards for services offered only through their own retail outlets would not be included unless there was a large enough secondary market for their cards to give them general purchasing power.

- Parties that conduct payment services as independent contractors or as agents for payment services providers would generally not be required to be members; they would probably, however, find voluntary membership valuable.

The Regulatory Advisory Group found that a totally definitive formula was not possible. The legislation should, however, give entities some certainty about their status as payment service providers, provide flexibility for the definition in regulation, and establish the body that makes the decision. The recommended public oversight body was seen as the best candidate for this role.

## 2. Principles-based legislation

The Task Force favours a governance model that is minimally intrusive but responsive to challenges. It strongly believes that the regime should not be characterized by a host of prescriptive regulations. Rather, it should be based explicitly on simple but powerful principles.

Specifically, the legislated regime should pursue the basic principles of trust, access and good value, as discussed in *Policy Paper A*. The Task Force would leave it to drafting experts to determine how best to embed these principles and the objectives derived from them in the legislative framework.

## 3. Public oversight body

A key provision of the legislation implementing the recommended governance model would be the creation of a public oversight body (POB). Reporting to the Minister of Finance and with delegated decision-making authority, the POB would be charged with carrying out responsibilities including:

- Statutory authority to oversee the payments system and its participants, to recognize and oversee self-governing organizations (SGOs) and to offer recourse for stakeholders.
- Authority to set the terms and conditions for recognizing an SGO, to ensure that all payment service providers are brought within it and to delegate registration and licensing authority to it, while maintaining power to direct the SGO.
- Where there is no effectively functioning SGO, the POB would exercise the regulatory powers granted under legislation.

Although the proposed legislation would allow for more than one SGO, the Task Force recommends that there be only one for the payments industry.

## 4. Infrastructure entity

As discussed in *Policy Paper D*, the Task Force recommends that the corporate structure of the Canadian Payments Association (CPA) be reinvented to address a number of issues and to enable the CPA to serve effectively as the necessary infrastructure entity. This would require amendments to the *Canadian Payments Act*.

### *Other considerations*

The paper explores the implications of the recommended changes for other agencies and legislation, both federal and provincial, including the Financial Consumer Agency of Canada and the *Bills of Exchange Act*. It also looks at legislation that is impeding the transition to digital payments and at special requirements of anti-money laundering provisions.

## Introduction

In the previous papers, we outlined principles for a reformed Canadian payments system, as well as a recommended governance model to equip the government and stakeholders with the tools to anticipate and address emerging payments issues in a timely fashion. The model recognizes that payment services are increasingly distinct from the traditional types of financial services activities that are regulated through existing legislation in areas such as banking, securities and insurance.

Legislation will be needed to implement this governance model. The legislation must reflect the principles upon which the model is based. Those principles include proportional, risk-based regulation; an emphasis on an inclusive approach to industry self-governance; and effective oversight to ensure that significant challenges that arise are addressed before ministerial intervention becomes necessary.

This paper outlines the considerations for legislation that would achieve these objectives. In recommending these ideas, we acknowledge the valuable input and advice that the Task Force received from the Regulatory Advisory Group and from the Consumer Advisory Group. This paper is largely based on that input.

## Existing legislative landscape

Canada has an extensive range of laws and regulations relating to payments. For example, the rules by which payments are cleared or settled through the systems of the Canadian Payments Association (CPA) are legally binding on members of the CPA under the *Canadian Payments Act* (CP Act). The CP Act requires new or amended CPA rules to be sent to the Minister of Finance for review (non-disapproval) and new or amended CPA bylaws to be submitted for the Minister's approval. Annex C1 lists key provisions of current payments-related legislation in Canada.

When payments were almost exclusively the domain of regulated financial institutions, it was possible to address challenges through amendments to financial institution statutes (such as the *Bank Act*). However, payments services are now increasingly offered by firms that are not regulated as traditional financial institutions. Consequently, financial institutions legislation is less useful as a tool for ensuring the appropriate regulatory checks and balances. For that reason, in their submissions to the Task Force, many stakeholders argued for a more consistent regulatory environment and a more comprehensive legislative approach to payments.

Protection for payments is also found in other laws of general application. For example, there are provisions on the priority of payments in the *Bankruptcy and Insolvency Act*, as well as in other federal insolvency statutes. The *Competition Act* provides protection against anti-competitive behaviour and applies to all entities within the payments system. Likewise, the *Personal Information Protection and Electronic Documents Act* sets minimum standards for the handling of private information that are fully applicable to the payments system. The *Bills of Exchange Act* sets out the rules governing the transfer of funds based on a specific payment instrument. The rules apply to cheques and to similar paper-based payment instruments (referred to as bills of exchange) but not to other types of payments (e.g., electronic payments).

Despite the existence of these laws, the introduction of new payments legislation over the last 20 years demonstrates that challenges have arisen that are specific to types of payments rather than to types of institutions. A prime example of such a law is the *Payment Card Networks Act*, which identifies networks subject to the Act based on a function being performed, not on the type of institutions carrying it out. This represents a functional approach to regulation as opposed to an institutional approach.

**Box C1: Payment laws and the organizations they target**

- *Canadian Payments Act*, Part 1 —Creates the Canadian Payments Association and sets out its powers, governance and membership.
- *Canadian Payments Act*, Part 2—Sets out the powers of the federal Minister of Finance to designate, when satisfied that it is in the public interest to do so, payments systems that are national in scope and that play a major role in supporting transactions in Canadian financial markets or the Canadian economy.
- *Payment Clearing and Settlement Act*—Sets out the powers of the Governor of the Bank of Canada to designate payments and other clearing and settlement systems as systemically important and to oversee such designated systems.<sup>1</sup> It includes provisions that increase the certainty that legal arrangements governing the operations of a designated system will produce the expected results and prevent legal issues such as bankruptcy proceedings and court injunctions.
- *Payment Card Networks Act* (PCNA)—Provides the federal Minister of Finance with oversight powers with respect to the business practices of enterprises that use national payment card networks to transmit payment messages.<sup>2</sup>
- *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*—Imposes customer identification, record keeping and reporting requirements on specified financial and non-financial entities.
- Provincial gift card legislation—Sets out the user protection rules associated with the issuance and fee setting of some forms of gift cards.

## Assessment of the existing regime

A broad review by the Regulatory Advisory Group found that the existing system of laws, rules and codes that govern the payments industry, while complex and fragmented, is relatively complete. The review identified only a few significant gaps in the Canadian legislative regime when compared with those of other relevant jurisdictions (see Annex C4).

This finding may seem comforting, but the lack of an overarching legislative framework to provide coherence and responsiveness in dealing with a changing situation does not bode well for the future. For example, one of the most important gaps in the current regulatory regime means that newer players (PayPal, Zoompass, etc.) are subject to no oversight at all. Moreover, differing degrees of protection are afforded to users of payment systems depending on the type of service they are using and on the provider of the service. In meetings and in submissions, the Task Force was repeatedly told about the challenges users face in understanding their basic rights and obligations. We learned that even if consumers diligently pore over the various contracts, laws, rules, codes and other governing documents, they will still not have a clear understanding of their rights and obligations. The current lack of transparency and clear disclosure is

illustrated in *Policy Paper A: Users and their Discontent* by the case of the imaginary consumer Sonia.<sup>3</sup> Such problems will only increase as the Canadian payments system evolves.

Consequently, to provide a basis for regulatory intervention, the government has had to resort to ad hoc measures such as introducing new legislation to target specific problems in the payments industry. A case in point is the *Payment Card Networks Act*, mentioned earlier. This ad hoc approach adds delays and uncertainty, detracting from the government's ability to intervene should problems arise in a particular industry segment or among groups of participants that fall outside the traditional regulated financial sector.

By defining the payments industry as a distinct sector, the recommended governance model would eliminate the future need for targeted legislation to deal with undesirable practices or unregulated players.

The primary goals of the new legislation would be:

- To define the industry,
- To establish a principles-based oversight function, and
- To provide for the recognition of self-governing organizations and the delegation of rule-making and enforcement responsibilities to them.

The Task Force favours an approach that places the primary responsibility for addressing emerging issues in the hands of stakeholders through a self-governing body. We recognize that this approach requires creating a comprehensive but proportional, risk-based legislative framework that does not exist today.

## Legislation to support the recommended governance model

The governance model recommended in *Policy Paper B: Governance—Stakeholders and their Disconnect* seeks to create an environment in which policy issues are identified and resolved before they reach a critical point. Its inclusive nature is designed to make the best use of the expertise and advice of stakeholders in anticipating challenges and in identifying creative solutions. To be effective, the framework must take a comprehensive approach to the oversight and regulation of the payments system.

In order to create the recommended governance model, legislation will be required.

1. This legislation should **define the payments industry** and have authority over all payments service providers, not just over financial institutions or payment networks.
2. It should **be principles-based** (rather than prescriptive) and should reflect the core policy objectives of trust, access and good value (outlined in *Policy Paper A*).
3. It should **provide for oversight and regulation**. To do this, the legislation should create a public oversight body and empower it to recognize one or more self-governing organizations and to delegate policy-making and some oversight responsibility to them. The legislation should also allow the government to issue regulations on the advice of the public oversight body; this power would be used if the self-governing organization was unable to resolve a policy issue.<sup>4</sup>
4. The legislation should also **strengthen core infrastructure** by reinventing the Canadian Payments Association, the provider of core infrastructure for the payments system.



Because the payments system is essential to all Canadians and affects virtually every aspect of their lives, it must function effectively and consistently across Canada and must interoperate seamlessly with other systems internationally. Given the important and long-standing role of federal legislation in the area of Canadian banking and payments, the Task Force believes that the legislative foundation for the industry should be provided through a federal payments act. To achieve full implementation, however, the governance model may need to be tailored to interact constructively with provincial and international legislation. The Task Force is confident that all levels of government in Canada, as well as those abroad, will find it in their respective interests to support the governance model as required. Consequently, jurisdictional issues should not be a barrier to implementing the governance model as envisaged in our report.

In the following sections, we explore these four key aspects of the required legislation.

## **1. Scope of legislation—Defining the payments industry**

As noted above, the Task Force believes that new payments legislation should encompass the entire payments industry and take a functional approach. By definition, this involves identifying entities that are to be subject to the regime based on the function they perform rather than on what type of institution they are.<sup>5</sup> As the payments sector becomes increasingly complex and populated with new types of players at different points in the value chain, even developing a functional definition that accurately reflects the full scope of the industry’s activities is not a simple task, particularly for a sector that is in rapid transformation.

The Task Force set about tackling this challenge by looking at the basic definition of a payments system, starting with the definition contained in its own mandate. Over the course of its work, the Task Force adapted the wording based on the recommendations of the Regulatory Advisory Group. The following is the working definition that emerged:

*The payments system refers to arrangements that allow consumers, businesses and other organizations to transfer monetary value from one party to another. It includes the institutions, instruments and services that facilitate the transfer of monetary value between parties in a transaction.*<sup>6</sup>

The legislation would need to set out the criteria for an entity to be subject to the regime in terms of the functions it performs in the payments system. In broad terms, such an entity or “payment service provider” is one that facilitates the transfer of monetary value from one party to another. How directly the entity’s activities relate to facilitating the transfer of value should be what determines whether it is a payment service provider for the purposes of the legislation. For example, a network operator that sets rules for its payment system is clearly a more direct facilitator than a telecommunications company that merely supplies the technical means by which the payment information is transferred.

### Box C2 – Payments vs. deposits

The need to recognize payments as a function distinct from other financial services, particularly deposit-taking, was fundamental to the work of the Task Force.

In the past, funds were typically stored in deposit accounts at a traditional bank or other financial institution. Customers who wanted cash went to a branch or, in later years, to an automated banking machine, to withdraw it. Eventually, debit cards allowed customers to make payments directly from their account. Alternatively, if customers were creditworthy, banks would allow them to purchase goods and services on credit for later settlement from their accounts. Credit cards and bank accounts were at the heart of our ability to make payments by means other than cash.

The world is changing. New entrants to the payments market offer “accounts” that serve the same essential payment function as a deposit account; these new players are particularly but not exclusively active in the online world. Their services allow customers to load prepaid cards and make routine payments. These stored-value payment vehicles delink the payment from a deposit account. Many large retailers offer charge cards, usually for use only in their own stores. Telecommunications companies allow customers to pay for services on their phone bill, thereby offering a credit-based payments service resembling a charge-card transaction. More significantly, new payments options being developed by companies such as PayPal enable buyers to make a purchase now and to decide later how to pay for it.

The future of payments clearly lies in immediate funds transfer. Implementation of such a system will dramatically reduce the risks posed by delays between issuing payment instructions and executing them. At the same time, improvements in security (especially through online digital identification and authentication) will enable payment services suppliers to capture payment instructions and execute transfers for value with little risk. Furthermore, as the U.S. Automated Clearing House network shows, payment systems can open up to allow non-financial institutions to participate more directly in issuing payment instructions.

For years the payments value chain has been disaggregating, with specialized providers offering cost-efficient services to fulfil discrete functions. Payment networks such as the Canadian Payments Association, Visa, MasterCard and Interac simplify what would otherwise be a complex and potentially incompatible tangle of bilateral connections between individual financial institutions. The transition of Visa and MasterCard from associations of deposit-taking institutions to separate, publicly traded companies was another step toward disaggregation. The business of acquiring or processing payments instructions from retailers has also moved beyond traditional financial institutions to newer players such as Moneris, Global Payments and PayPal. As a result, where once there were only a few, there are now many payment service providers in the Canadian payments system, each staking claim to a piece of the payments value chain. And the trend shows no sign of slowing down. In fact, new players like Apple, Facebook, Amazon and Google are re-aggregating payments into entirely new information-based value propositions.

As a result, the payments system is shifting away from the store-of-value account or credit account as the central focus to networks and other payment service providers whose role is to carry out payment instructions (i.e., to move value from one party to another). Because of the many challenges this shift brings, public policy must also shift from deposits to payments activities. This was an important distinction in the minds of Task Force members as we developed our recommendations.

Recognizing that the definition would be critical to establishing the legislation, the Task Force asked the Regulatory Advisory Group to consider the challenging issue of scope. The Regulatory Advisory Group studied how other jurisdictions have addressed the definition issue<sup>7</sup> and examined which players in the Canadian market should be included in or excluded from the definition (see Annex C2). Some interesting observations emerged:

- There was minimal deliberation about entities that are traditionally considered part of the payments industry, such as the financial institutions that hold balances used for making payments, network operators, credit and debit card issuers, and acquirers. New industry participants such as online payment networks and suppliers of electronic online or mobile wallets were also readily identified as candidates for the regime.
- There was also general agreement that issuers of prepaid and gift cards should not be subject to the regime if their services are offered only through their own retail outlets. It was recognized that there would be some grey zones around this (e.g., a gift card that is redeemable at multiple outlets within that mall). Cards that become readily tradable would take on the characteristics of currency and would need to be treated as part of the payments system.
- It was concluded that the framework should not include parties that simply conduct payments activities as independent contractors or as agents for others. While the Task Force felt that bill payers and payroll processors would have to be included, there were many companies in areas such as Internet service or telecommunications support that would not. The decision would not be based on the type of company per se, but on the functions it performs in relation to the payments system. Some of these companies would be in, others out.<sup>8</sup>

One of the Regulatory Advisory Group's most significant observations was that it would be impossible to arrive at a definition of a payment service provider that would perfectly delineate which entities are subject to the regime and which are not.

There are different approaches to this issue. For example, the European approach defines the industry broadly and then exempts specific entities and activities from regulation. Another approach is to make the definition fairly narrow and then add specific activities as they become significant. Members of the Regulatory Advisory Group felt that the legislation would need to have flexibility and frequent reviews built into its approach to determining scope. The legislation should provide for the following:

1. A licensing regime that allows an entity to know with certainty whether it is a payment service provider subject to the legislation;
2. A definition of a payment service provider that can be expanded and provide exemptions by regulation as the market place changes and as experience indicates that a borderline participant may be safely excused; and
3. A body that has the authority to determine whether an entity falls within the definition of a payment service provider and to identify and compel entities that fall within the legal definition to register. Ideally, that same organization would administer the licensing regime.

There was strong agreement among Regulatory Advisory Group members that the entity best positioned to carry out the latter function within the recommended governance framework would be the new public oversight body (POB), as it would be perceived to be more objective than the self-governing organization (SGO) at assessing, from a public interest standpoint, which organizations should be required to be SGO members.

## 2. Principles-based legislation—Guiding self-governance

As noted in *Policy Paper B*, the Task Force favours a governance model that is minimally intrusive yet responsive to challenges arising in the payments industry. The regime will require regulation-making authority to deal with any undesirable practices that the SGO fails to address, but the Task Force strongly believes that it should not be characterized by a host of prescriptive regulations.

It is not sufficient to ask simply that the governance model operate in the public interest. Ultimately, there are trade-offs in any policy framework. For example, while minimum standards of access to a network may be necessary to ensure safety and soundness, those standards should not be so stringent as to limit competition by restricting access for new entrants. Someone must take responsibility for those difficult decisions. As evidenced by the *Code of Conduct for the Credit and Debit Card Industry in Canada*, the federal Minister of Finance is considered the person ultimately accountable. In a well-functioning system, however, most such concerns should be dealt with before they reach the Minister.

The recommended governance framework allows for the delegation of this responsibility to the new POB and, ultimately, to the industry itself through a self-governing model. However, the delegation should not be without direction. The concept of delegation subject to principles ensures that the delegated institutions have adequate guidance to carry out their responsibilities. In other words, the principles clarify the public policy considerations critical to ensuring that the public interest is well served.

In its discussion document, *The Way We Pay*, the Task Force outlined the 12 principles it had adopted to guide its own work. These were informed by input from numerous stakeholders, including submissions in response to the discussion document. Challenges were raised, particularly with respect to the value of this particular formulation as a guide for the POB and the industry. For this reason, the Task Force asked its Consumer Advisory Group to examine the original principles with a view to arriving at a shorter and more robust statement that would be more practical in providing policy guidance.

As noted in *Policy Paper A*, the Consumer Advisory Group created a new set of principles built on three simple themes, which the Task Force endorses as the foundation of a successful payments system:

- Participants must **trust** it.
- Participants must be able to use it (i.e., to **access** it).
- The system must provide **good value**.

The Task Force concluded that these core principles expressing the public interest should be at the heart of the governance model. Accordingly, the Consumer Advisory Group went on to illustrate how the principles might be developed into objectives and sub-objectives by offering the proposed National Payments Policy shown in Box C3.

### Box C3: Proposed National Payments Policy

The payments system performs an essential role in the Canadian economy and society. In order to optimize the total economic and social welfare of all its participants, ensure its efficiency and guide its evolution and development, the Canadian payments system shall be governed by the following objectives:

#### Trust

- (a) Generate and maintain a high level of trust among participants by being demonstrably:
  - (i) Financially stable and safe with regard to the level of risk created or incurred by participants;
  - (ii) Fair, reasonable and proportionate in the assignment of costs, benefits, rights and responsibilities among all participants, taking into account all relevant factors, including the level of risk involved and the ability of participants to prevent and bear risk and costs;
  - (iii) Operationally robust, and able to process payments in a timely and accurate manner;
  - (iv) Secure and able to protect the integrity and privacy of information;
  - (v) Providing easily accessible and understandable rules governing its use, the prices charged to participants and the information provided thereto;
  - (vi) Held in compliance with appropriate regulatory oversight by public agencies and authorized self-regulatory organizations;
  - (vii) Supported by easily understandable, impartial and accessible systems of redress that are responsive and efficient and that include independent appeal processes; and
  - (viii) Governed in a way that provides all categories of participants with a reasonable opportunity to provide input into its governance, development and use.

#### Accessibility

- (b) Be easily accessible to all participants who use payment mechanisms and supportive of a reasonable expectation that they can choose among adequate payment mechanisms by ensuring:
  - (i) The provision of effective and efficient services throughout Canada;
  - (ii) The delivery of adequate and affordable services that are available independently of participants' socio-economic and demographic circumstances or commercial significance; and
  - (iii) The provision of services that are easy to use and that accommodate participants of all skills and abilities.

#### Good value

- (c) Provide good value by:
  - (i) Operating in a way that delivers the most efficient costs to participants, consistent with the objectives of the National Payments Policy;
  - (ii) Establishing an efficient and consistent regulatory framework that applies to all participants and is founded on functional neutrality;
  - (iii) Facilitating competition among a wide variety of providers and services, including through the elimination of unnecessary barriers; and
  - (iv) Promoting interoperability, both at the national and international levels.

These objectives apply as reasonably appropriate to the different participants in the Canadian payments system, with due regard being given to the diversity of their circumstances.

The Consumer Advisory Group's explanation of the proposed policy is presented in Annex C5.

As noted in Box C4: Principles and Legislation, this proposal of the Consumer Advisory Group is offered as a starting point from which the government can move forward from the principles to develop a definitive set of objectives for the Canadian payments system.

The Regulatory Advisory Group also considered how best to embed the policy principles and the resulting objectives in the new legislative framework. This is no simple matter, and the Task Force thought it would be best to refer the issue to legislative drafting experts (see Box C4).

#### **Box C4: Principles and legislation**

The proposed National Payments Policy provides detail as to how the three principles (trust, access and good value) might be applied to the payments system. It should serve as a useful guide to both industry and government at the highest policy levels. It must be understood, however, that the application of specific parts of the objectives will inevitably vary with circumstances.

This leads to the question of how to capture these principles in the governance model and in the legislation. Among the options considered were embedding the objectives in recitals to the legislation ("whereas" statements) or appending them as an annex to the legislation with provisions that describe their specific role as guiding principles as opposed to absolute rules. From there, organizations within the governance model, such as the public oversight body, could develop their respective mandates with reference to these principles but have the flexibility to adapt them to the organization's own roles and responsibilities.

Although there are examples of policy statements embedded in various ways in legislation,<sup>9</sup> the Regulatory Advisory Group expressed strong reservations about such an approach. It was recognized, however, that if the legislation does not explicitly contain the principles, there is a risk that they will be lost over time.

While not offering a specific recommendation, the Task Force proposes that the framers of the legislation seek to embed in it an expression of the public interest in the payments system.

One issue is whether detailed objectives such as those set out in the National Payments Policy could be consistently applied to all aspects of the payments system (from policymakers at the top right down to individual firms subject to the governance framework). The Task Force recognized that the core principles of trust, access and good value were appropriate guidance – to provide a public policy perspective for the government – but doubts were raised that specific objectives could be applied at every level within the framework. "The Task Force recognized that the core principles of trust, access and good value were appropriate guidance – to provide a public policy perspective for the government – but doubts were raised that specific objectives could be applied at every level within the framework."

In shaping the proposed policy, the Task Force took into account concerns that all the specific objectives of such a comprehensive policy statement could not be applied equally at every level within the model. For example, while it would be reasonable to expect government to ensure, from a policy standpoint, that our payments system be "supportive of a reasonable expectation that [all participants] can choose among adequate payment mechanisms by ensuring the provision of effective and efficient services throughout Canada," it is not the intention of this objective that individual payments providers be forced to extend their services to the entire country. However, should there be a systemic gap that leads to an unreasonable

shortage of payments services in some parts of Canada, this objective would suggest, appropriately, that government, at a policy level, consider how to address the issue.

### **3. Recommended public oversight body**

At the heart of the legislation implementing the recommended governance model would be the creation of a POB. Reporting to the Minister of Finance, the POB would carry out oversight responsibilities in respect of the payments industry as defined in the payments legislation. This would include:

- Statutory authority to:
  - a) Oversee the payments system and its participants (as defined) in accordance with the public interest as set out in legislation;
  - b) Recognize and oversee SGOs for the payments system; and
  - c) Offer a recourse mechanism for issues that cannot be resolved by the SGO.
- Under its power to recognize an SGO, the authority to set the terms and conditions for such recognition and to delegate all or part of its registration, licensing and regulatory authority to that SGO, while maintaining directive power over it.
- Where a payments SGO is functioning effectively, retain residual regulatory authority over payment service providers subject to the new payments legislation, but not normally exercise it. Where there is no effectively functioning SGO, the POB would continue to exercise the regulatory powers granted under legislation.

The POB would have the mandate to maintain oversight of the Canadian payments system using a proportional, risk-based approach, and, where necessary, to enforce payments legislation and regulations. To do this, it would need to have an independent view on the evolution of the payments industry and be able to assess within the governance model the implications of changes. The POB could also assess and report on the conduct of payments system participants subject to the legislation. Where delegated, an SGO would be expected to develop and enforce codes, policies and standards that are consistent with the principles laid out in legislation or with specific direction from the POB.

The POB would have directive power in respect of an SGO to ensure compliance with regulations and to require that the practices of the SGO be carried out in a manner consistent with principles and objectives spelled out in the legislation. The legislation would allow the POB to negotiate a recognition order specifying key aspects of an SGO's governance and mandate. For example, the POB might maintain authority to nominate or approve some or all of the SGO's independent directors. The Recognition Order might also specify, for example, a policy of staged intervention by the POB in the affairs of the SGO should problems reach a certain minimum threshold (similar in concept to the escalating intervention role of the Office of the Superintendent of Financial Institutions in the case of troubled financial institutions).

The legislation would also recognize the POB as a formal recourse mechanism for unresolved conflicts arising in an SGO. For example, SGO decisions related to the setting of policies, standards or codes of conduct, as well as decisions regarding member compliance with them, would be eligible for appeal. It is expected that this appeal process would be tied to the POB's directive power.

The legislation would spell out the governance of the POB, including the appointment of its board and the executive director and its role as an agency of government responsible to the Minister of Finance. The POB itself would be subject to a power of direction by the Minister of Finance and would be required to report regularly to the Minister on its oversight observations and operations.

**Box C5: Public oversight body governance details**

In consultation with the Governance Advisory Group, the Task Force recommends that:

- The POB be headed by a small board of five to seven senior people. Board member expertise would include senior-level public policy, strategic policy, payments and/or financial services (legal, accounting or business), corporate or consumer/public interest.
- The POB have one member representing the Bank of Canada.
- The members of the POB be nominated by a committee consisting of the Governor of the Bank of Canada (chair), the Deputy Minister of Finance, the Deputy Minister of Industry, and one independent member (agreed upon by the other three committee members). This committee would make recommendations to the Minister of Finance, for appointment through the Governor-in-Council process.

These features would need to be captured in legislation.

#### **4. Infrastructure entity (reinvented Canadian Payments Association)**

As discussed in *Policy Paper D: Infrastructure—A Reinvented Canadian Payments Association*, the Task Force recommends that the CPA's corporate structure be remodelled to address a number of issues.

The CPA, as the owner and operator of core payments infrastructure, would be considered a payments service provider for the purposes of the governance framework. This would be made clear by the legislation.

Because the CPA was created through an act of Parliament (the CP Act), legislation would be required to transform its role and governance. *Policy Paper D* outlines the specific recommendations of the Task Force for amendments to the CP Act. This includes amending the objects, metrics, funding and pricing model and scope of CPA activities to provide it with the mandate and resources required to upgrade Canada's core payments infrastructure to meet the needs of the digital age.

The legislation would spell out the new governance of the CPA, including the qualifications, nomination process and structure of board membership, in accordance with good governance practices. From a public interest perspective and as a key player in the payments system, the CPA would be subject to oversight by the POB, and its bylaws and rules would therefore no longer need the approval or non-disapproval, respectively, of the Minister. As a member of the SGO, the CPA would be expected to comply with the standards, rules and codes it pronounces.



## Implications for existing statutes and legislative priority

The new payments legislation is not intended to replace existing legislation. Rather, the purpose is to fill the legislative voids that exist today. Existing laws, both federal and provincial, would continue to apply to various segments of the payments sector. This includes general-purpose legislation, such as privacy and competition laws, as well as laws targeting specific issues, such as provincial gift card legislation and designation powers under the *Payment, Clearing and Settlement Act*. The latter grants the Bank of Canada authority to designate and oversee systemically important payments and other clearing and settlement systems. The expectation, though, is that the recommended model will provide a means to address payment industry issues as they arise, thereby minimizing the need for future ad hoc legislative action on the part of governments.

The Task Force believes that some minimal rationalization of existing payments legislation may be needed. For example, the powers recently granted to the Financial Consumer Agency of Canada in relation to overseeing codes of conduct for payment card networks would not be needed if new authorities were granted to the POB or subsequently to a payments SGO. With this exception, the new legislation would be drafted so as to clearly indicate that it is not intended to diminish in any way the role of other existing statutes.

### Oversight coordination

As mentioned, payments services are often offered by entities that are subject to different regulatory schemes or to none at all. When legislation, codes of conduct and standards are developed, every effort should be made to ensure that the new rules and regulations are aligned with or complement the existing regime. Nevertheless, there may still be intersection points among the regulatory and oversight functions of some institutions that require coordination between them.

One way to provide such coordination is to create an informal body that brings together key regulatory and policy heads in a forum to identify and address potential coordination issues. A model exists for a regulatory policy forum in the case of federally regulated financial institutions. The Senior Advisory Committee (SAC) is an informal body composed of the Deputy Minister of Finance (who chairs the Committee), the Superintendent of Financial Institutions, the Commissioner of the Financial Consumer Agency of Canada, the Governor of the Bank of Canada and the Chairperson of the Canada Deposit Insurance Corporation. The SAC is used as a forum for discussing financial sector policy and legislative issues. In the case of payments, as the roles of the POB and the SGO evolve and as the industry develops, it will be necessary to ensure coordination and clarity with respect to the roles and responsibilities of the various agencies involved. To this end, a forum similar to the SAC will be needed to achieve effective oversight.

### *Bills of Exchange Act*

Current Canadian legislation governing payments is mainly targeted at paper instruments (e.g., cheques and currency). Although the Task Force calls for changes that reduce our reliance on cheques, cheques will remain in use for some time. As a result, many stakeholders continue to ask for an update of provisions in the

*Bills of Exchange Act* relating to cheques and other paper instruments, which are used extensively by consumers, merchants, businesses and governments. Much of that act has remained unchanged for a century. The Task Force encourages the government to consider changes to make the legislation less technical and more accessible to the general public, to enhance consumer protection and to recognize advances in technology used for payments. Such changes should not, however, prolong the use of cheques in Canada. A targeted consultation on these matters should be contemplated by the government.

## **Legislative impediments to a digital economy**

The digital economy is transforming not just how we make and receive payments but also how we conduct a wide range of other transactions. Carrying out routine activities online, such as purchasing tickets for a movie, is the most obvious example of this new paradigm and represents only the tip of the iceberg in terms of the opportunities that the new technologies will bring.

As the digital economy transforms many of our transactions, our payments experience will change too. Key among the changes will be the elimination of requirements such as our physical presence for financial transactions or tangible means of verification such as payment cards, cheques, signatures and photo identification.

The federal and provincial governments have already taken large steps to update legislation so as to accommodate alternative payment media. Statutes that once referred only to payments by cheque or cash, including most of the financial administration acts, now refer to electronic forms of payment. While this marks a significant step toward electronic payments, it is important to ensure that new legislation more fully accommodates payments in a digital economy. The Task Force recommends that governments conduct a thorough review of their legislation and regulations to ensure that provisions do not preclude online transactions and thereby hamper the transition to a digital economy.

## **Anti-money laundering and anti-terrorist financing legislation**

The *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*—Canada’s anti-money laundering and anti-terrorist financing legislation (AML/ATF legislation)—contains measures to assist with the detection and deterrence of money laundering and terrorist financing activities. The Act creates obligations for certain financial and non-financial entities with respect to customer identification, record keeping and internal compliance; and establishes a mandatory system for reporting suspicious financial transactions and certain other prescribed transactions.

In terms of customer identification, the AML/ATF legislation and regulations spell out the means by which the identity of an individual must be ascertained in certain circumstances. The primary methods are based on in-person confirmation, namely, by “referring to the person’s birth certificate, driver’s licence, provincial health insurance card . . . passport or other similar document.” The regulations cover situations in which a person is not physically present when conducting a specified transaction (e.g., opening an account). In those cases, options for verifying identity include using an agent to perform a face-to-face identification or a combination of alternative identification methods, some of which may require an individual to present himself or herself in person, or to provide supporting material.

Industry is eager to take advantage of new and emerging technologies that would allow for more robust and flexible client identity verification. Regulators may, however, be reluctant to make changes to the rules until the full risks are better understood and until the new approaches are confirmed to be consistent with public policy underlying the AML/ATF legislation. As outlined in *Going Digital*, digital identification and authentication (DIA) offers the potential for a more secure means of verifying identity without the need for a physical presence.

Governments have a need to enforce public policy with respect to AML/ATF legislation. Industry has an interest in ensuring that the rules flowing from AML/ATF legislation do not unnecessarily obstruct innovation in payments services. The Task Force strongly believes that this is an area where collaboration offers tremendous opportunity to find win-win solutions that free up payment service providers to create new services for clients while enhancing the integrity of client identity verification practices through DIA.

## Conclusion

In this paper, we have outlined the legislative changes needed to implement the recommended governance model for the Canadian payments system. As stated at the outset, the key goal is to create a legislative framework that is minimally intrusive, using self-governance instead of regulation to the greatest extent possible.

As with the other work of the Task Force, this paper is intended as a starting point for dialogue on how best to implement a new governance model for the Canadian payments system. We trust that stakeholders will continue to provide their valuable support and input as the federal government reviews and considers our recommendations.

## Annex C1: Current payment-related legislation in Canada

### *Federal legislation, regulation and rules*

#### **Method of payment**

These pieces of legislation define different acceptable means of payments and the legal requirements for those methods of payments to be acceptable. They also outline the rights and responsibilities of either those issuing the payment method or those using or cashing in the payment method.

##### *Bills of Exchange Act*

Part I – General

Part II – Bills of Exchange

Part III – Cheques on a Bank (also covers cheques drawn on non-bank members of the Canadian Payments Association)

Part IV – Promissory Notes

Part V – Consumer Bills and Notes

##### *Currency Act*

Part I – Currency and Coinage (Currency issue is also governed by section 25 of the *Bank of Canada Act*. Coinage is also governed by sections 6 and 7 of the *Royal Canadian Mint Act*.)

#### **Clearing and settlement of payments**

These pieces of legislation define clearing and settlement systems and how they should be regulated. Part of the legislation also outlines the approval process for the clearing and settlement system owned and operated by the Canadian Payments Association.

##### *Canadian Payments Act*

Part 1 – Canadian Payments Association

Part 2 – Designated Payment Systems

Part 3 – General

##### *Payment Clearing and Settlement Act*

Part I – Clearing and Settlement System Regulation

Part II – General

#### **Regulation specific to participant types**

These pieces of legislation regulate the functions of one or more specific participants in the payments system. Although there is a much longer list, only one applies solely to payments (e.g., parts of the *Bank Act* apply to the payments system, but it is mainly written for banks not for payments).

*Payment Card Networks Act* – not yet implemented by regulations

*Credit Business Practices (Banks, Authorized Foreign Banks, Trust and Loan Companies, Retail Associations, Canadian Insurance Companies and Foreign Insurance Companies) Regulations*

The current legislative and regulatory framework for the payments industry includes not only the legislation listed above but also a number of bylaws, codes, rules and standards.

***Canadian Payments Association (CPA) bylaws***

***Canadian Payments Association By-law No. 1 – General***

- Provisions cover the board of directors, the committees of the board, the advisory council, and registration and application for membership by banks and authorized foreign banks and others.

***Canadian Payments Association By-law No. 2 – Finance***

- Provisions cover the CPA budget, members' dues and fees.

***Canadian Payments Association By-law No. 3 – Payment Items and Automated Clearing Settlement System (ACSS)***

- Provisions cover payment items acceptable for clearing; exchange, clearing and settlement; return of payment items; participation in the ACSS.

***Canadian Payments Association By-law No. 6 – Compliance***

- Provisions cover the conduct of investigation, sanctions and expenses, compliance report, and enforcement and collection.

***Canadian Payments Association By-law No. 7 – Respecting the Large Value Transfer System (LVTS)***

- Provisions cover the administration and operation of the LVTS, access to the LVTS, the pledging of collateral, collateral requirements, the finality of payment to payees, and the procedure on default.

***Canadian Payments Association Rules and Standards***

The CPA has a number of rules and standards for its clearing and settlement systems, some of which have implications for payers and payees (e.g., rule H1 preauthorized debits).

***Codes of conduct***

Consumers and debit cards—*Canadian Code of Practice for Consumer Debit Card Services*

*Code of Conduct for the Credit and Debit Card Industry in Canada*

*Voluntary Commitment—Reduced Cheque Hold Periods*

*Principles of Consumer Protection for Electronic Commerce – A Canadian Framework*

## Provincial payment legislation and regulations

**Table C1: Provincial payment legislation and regulations—Consumer protection and gift cards**

Prov	Legislation/Regulation Title	Summary	Relevant Parts
ON	<i>Consumer Protection Act</i> , 2002, SO 2002, c 30	These pieces of legislation set out various consumer protections related to gift cards and prepaid cards and set out disclosure requirements on purchase agreements, as well as contracts for credit.	<b>Part II</b> —Consumer Rights and Warranties, <b>Part III</b> —Unfair Practices, <b>Part IV</b> - Rights and Obligations Respecting Specific Consumer Agreements
ON	General, O Reg 17/05, ( <i>Consumer Protection Act</i> , 2002)		
QC	<i>Consumer Protection Act</i> , RSQ, c P-40.1		<b>Chapter VI.1</b> —Contracts for the Sale of Prepaid Cards
QC	<i>Regulation respecting the application of the Consumer Protection Act</i>		
NS	<i>Consumer Protection Act</i> , RSNS 1989, c 92		sections 11, 17-19, 21, 24-25, 33
NS	<i>Consumer Protection Act Regulations</i> , NS Reg 160/2000		
NS	<i>Gift Card Regulations</i> , NS Reg 325/2009, ( <i>Consumer Protection Act</i> )		
NB	<i>Gift Cards Act</i> , SNB 2008, c G-3.5		All
NB	<i>General Regulation</i> , NB Reg 2008-152, ( <i>Gift Cards Act</i> )		
MB	<i>The Consumer Protection Act</i> , CCSM c C200		<b>Part II</b> —Credit Agreements and Leases: Cost of Credit, <b>Part XX</b> —Prepaid Purchase Cards
MB	<i>Consumer Protection Regulation</i> , Man Reg 227/2006		
MB	<i>Prepaid Purchase Card Regulation</i>		

BC	<i>Business Practices and Consumer Protection Act, SBC 2004, c 2</i>		<b>Part 4—Consumer Contracts, Part 4.1—</b> Prepaid Purchase Cards
BC	<i>Consumer Contracts Regulation</i>		
BC	<i>Prepaid Purchase Cards Regulation</i>		
PEI	<i>Consumer Protection Act, RSPEI 1988, c C-19</i>		None
PEI	<i>Gift Cards Act, RSPEI 1988, c G-4.1</i>		All
PEI	<i>General Regulations, PEI Reg EC346/10, (Gift Cards Act)</i>		
SK	<i>Consumer Protection Act, SS 1996, c C-30.1</i>		<b>Part IV.6—Prepaid Purchase Cards</b>
SK	<i>Consumer Protection Regulations, 2007, RRS c C-30.1 Reg 2, (Consumer Protection Act)</i>		
AB	<i>Gift Card Regulation, Alta Reg 146/2008, (Fair Trading Act)</i>		
AB	<i>Consumer Transaction Cancellation and Recovery Notice Regulation, Alta Reg 287/2006</i>		
NL	<i>Consumer Protection and Business Practices Act, SNL 2009, c C-31.1</i>		<b>Part VII—Cost of Consumer Credit Disclosure</b>
NL	<i>Gift Card Regulations, NLR 14/11, (Consumer Protection and Business Practices Act)</i>		
NT	<i>Consumer Protection Act, RSNWT 1988, c C-17</i>		None
YT	<i>Consumers Protection Act, RSY 2002, c 40</i>		None
NU	<i>Consumer Protection Act, RSNWT (Nu) 1988, c C-17</i>		None

**Table C2: Provincial payment legislation and regulations—Credit**

Prov	Legislation/Regulation Title	Summary	Relevant Parts
NS	<i>Consumer Creditors' Conduct Act</i> , RSNS 1989, c 91	These pieces of legislation regulate credit agreements, including credit cards.	All
NB	<i>Cost of Credit Disclosure Act</i> , SNB 2002, c C-28.3		All
BC	<i>Disclosure of the Cost of Consumer Credit Regulation</i> , BC Reg 273/2004		
SK	<i>Cost of Credit Disclosure Act</i> , 2002, SS 2002, c C-41.01		All
SK	<i>Cost of Credit Disclosure Regulations</i> , 2006, RRS c C-41.01 Reg 1, ( <i>Cost of Credit Disclosure Act</i> , 2002)		
AB	<i>Fair Trading Act</i> , RSA 2000, c F-2		<b>Part 9—Cost of Credit Disclosure</b>
AB	<i>Cost of Credit Disclosure Regulation</i> , Alta Reg 198/1999, ( <i>Fair Trading Act</i> )		
NL	<i>Cost of Consumer Credit Disclosure Regulations</i> , NLR 74/10, ( <i>Consumer Protection and Business Practices Act</i> )		All



**Table C3: Provincial payment legislation and regulations—Sale of goods**

Prov	Legislation/Regulation Title	Summary	Relevant Parts
ON	<i>Sale of Goods Act</i> , RSO 1990, c S-1	The Sale of Goods Acts defines what a contract for sale is and when it occurs.	<b>Part I</b> —Formation of the Contract
NS	<i>Sale of Goods Act</i> , RSNS 1989, c 408		<b>Part I</b> —Formation of the Contract
NB	<i>Sale of Goods Act</i> , RSNB 1973, c S-1		<b>Part I</b> —Formation of the Contract
MB	<i>The Sale of Goods Act</i> , CCSM c S10		<b>Part I</b> —Formation of the Contract
PEI	<i>Sale of Goods Act</i> , RSPEI 1988, c S-1		<b>Part I</b> —Formation of the Contract
SK	<i>Sale of Goods Act</i> , RSS 1978, c S-1		<b>Part I</b> —Formation of the Contract
AB	<i>Sale of Goods Act</i> , RSA 2000, c S-2		<b>Part I</b> —Formation of the Contract
NL	<i>Sale of Goods Act</i> , RSNL 1990, c S-6		<b>Part I</b> —Formation of the Contract
NT	<i>Sale of Goods Act</i> , RSNWT 1988, c S-2		Formation of a Contract of Sale
YT	<i>Sale of Goods Act</i> , RSY 2002, c 198		<b>Part I</b> —Formation of the Contract
NU	<i>Sale of Goods Act</i> , RSNWT (Nu) 1988, c S-2		Formation of a Contract of Sale

**Table C4: Provincial payment legislation and regulations—Other**

Prov	Legislation/Regulation Title	Summary	Relevant Parts
QC	<i>Money-Services Businesses Act</i>	Requires that persons operating services such as currency issue, redemption of travellers' cheques and cheque cashing, obtain a licence from Quebec	Chapters I - X

## Annex C2: Payments rules—A comparative taxonomy

This annex includes a list of payments issues that have been the subject of specific regulation either in Canada or in certain other countries of particular interest. This taxonomy of payment rules was developed to illustrate the range of measures that exist to address payments issues. The list was intended to assist the Regulatory Advisory Group in assessing potential gaps in the Canadian regulatory landscape for payments. Given that different regulatory solutions exist across jurisdictions to address similar payments issues, the taxonomy is organized around payments issues rather than around types of solutions adopted.

Although the powers to regulate payments in Canada are distributed throughout a number of statutes both federal and provincial, the Regulatory Advisory Group did not identify, in extensive discussions supported by the taxonomy, any significant gaps in payment regulation in Canada as compared with other key jurisdictions.

While efforts were made to make the list as comprehensive as possible, it was prepared for discussion and illustrative purposes only and should not be treated as an exhaustive account of payments-related rules either in Canada or elsewhere. Countries are listed only when they have relevant payments rules.

### Classification of payments institutions

Purpose: To allow differences in activities among payments providers to be reflected in user protection.

#### United States

- Regulations govern the activities of the following payment services:
  - Providers of electronic funds transfer service: Debit card issuers
  - Gift cards and gift certificates

#### European Union

- The Payment Services Directive (PSD) creates three types of payment service providers:
  - Credit institutions
  - Electronic money institutions
    - Subject to the E-Money Directive
  - Payments institutions
    - Registration and authorization requirements
    - Only payment accounts
- The PSD proposes different capital requirements for payments service providers that perform different activities.

### Safety and stability of payments systems

#### *Oversight of systemically important payments systems*

Purpose: To oversee and regulate payments systems that are sufficiently significant for the purpose of protecting the overall stability of the financial system.

## International

- In 2001, the Committee on Payment and Settlement Systems (CPSS) of the Bank for International Settlement developed a set of 10 core principles for systemically important systems. Those 10 core principles have been used by a number of countries as the basis for oversight. The CPSS has released for comment a new set of principles for financial market infrastructures that are more demanding for payment clearing and settlement (comments were requested by July 29, 2011).

## *Responsibility for designation*

Purpose: To meet the need for a competent authority to take responsibility for designation.

### Canada

- The *Payment Clearing and Settlement Act* gives the responsibility for the designation of clearing and settlement systems to the Governor of the Bank of Canada. It also requires that the Minister of Finance be of the opinion that it is in the public interest to do so.
- The *Canadian Payments Act* gives responsibility for the designation of certain payments systems to the Minister of Finance for the purposes of that act.

### United States

- The Federal Reserve Board is responsible for determining whether a system is systemically important.

### European Union

- The European Central Bank is responsible for promoting the smooth operation of the payment systems. It is also responsible for the oversight of the two European large-value payment systems (EURO 1 and Target). The central banks of individual European countries are responsible for the oversight of the national payments systems in those countries.

### United Kingdom

- U.K. Treasury is responsible for designating the clearing and settlement systems.
- The Bank of England is responsible for the oversight of the designated systems.

## *Types of designations*

Purpose: To recognize that a payments system can be designated for different purposes.

### Canada

- Two types of designation (*Canadian Payments Act* [CP Act]) and *Payment Clearing and Settlement Act* [PCSA]):
  - The Minister of Finance may designate a payment system if he or she is of the opinion that the payment system is national or substantially national in its scope or that the payment system plays a major role in supporting transactions in Canadian financial markets or the Canadian economy under the CP Act.
  - The Governor of the Bank of Canada may designate a clearing and settlement system if he or she is of the opinion that it may be operated in such a manner as to pose a systemic risk and if the Minister of Finance is of the opinion that it is in the public interest to do so for the purposes of the PCSA.

### United States

- Systemically important payments systems

**European Union**

- Large-value payment systems
- Retail payment systems
  - Retail systems of systemic importance
  - Retail systems of prominent importance
  - Other retail systems
- The Euro System has developed a generalized approach and a minimum set of common oversight standards for payment instruments.

**United Kingdom**

- Systemically important payment systems

***Criteria for designation***

Purpose: To establish the basis by which systems are designated.

**Canada**

- Factors to determine whether it is in the public interest to designate a payment system under the CP Act:
  - The level of financial safety provided by the payment system for participants and users,
  - The efficiency and competitiveness of payment systems in Canada, and
  - The best interests of the financial system in Canada.
- Factors considered in the assessment of a clearing and settlement system's designation as a systemically important system:
  - The size of individual payment obligations and the size of the aggregate value of payments obligations on any given day,
  - The size of payment obligations owed to and by participants in the system relative to each participant's capital, and
  - The role played by the system in supporting transactions in financial markets or in the economy more generally.

**United States**

- Factors the Federal Reserve Board considers to determine whether a system is systemically important include the following:
  - Whether the system has the potential to create significant liquidity disruptions or dislocations should it fail to perform or settle as expected,
  - Whether the system has the potential to create large credit or liquidity exposures relative to participants' financial capacity,
  - Whether the system settles a high proportion of large-value or interbank transactions,
  - Whether the system settles transactions for important financial markets,
  - Whether the system provides settlement for other systems, and
  - Whether the system is the only system or one of a very few systems for settlement of a given financial instrument.<sup>10</sup>

**European Union**

- Large-value payment systems: Based on the CPSS core principles for systemically important payment systems
- Retail payment system
- Retail systems of systemic importance
  - Characterized by a high degree of market penetration, high aggregate financial risks and a high risk of a domino effect. In addition to these commonly agreed indicators, central banks overseeing retail payment systems may take into account specificities that are peculiar to their respective payments market.<sup>11</sup>
- Retail systems of prominent importance
  - Systems that play a prominent role in the processing and settlement of retail payments and whose failure could have major economic effects and undermine the confidence of the public in payment systems and in the currency in general.<sup>12</sup>

**United Kingdom**

- If any deficiencies in the design of the system or any disruption of its operation would be likely to:
  - Threaten the stability of, or confidence in, the U.K. financial system, or
  - Have serious consequences for business or other interests throughout the United Kingdom.
- In considering whether to specify a system, the Treasury must consider the following:
  - The number and value of the transactions that the system presently processes or is likely to process in the future,
  - The nature of the transactions that the system processes,
  - Whether those transactions or their equivalent could be handled by other systems,
  - The relationship between the system and other systems, and
  - Whether the system is used by the Bank of England in the course of its role as a monetary authority.<sup>13</sup>

***Overseer's powers***

Purpose: To establish the powers of the overseer with respect to designated systems.

**Canada**

- Operators of designated systems are required to provide the Bank of Canada with reasonable notice of advance of any change (e.g. clearing house bylaws, operations of the system, any documents governing the system).
- The Bank of Canada may conduct audits and inspections of a clearing house, and every clearing house shall assist the Bank to the extent necessary to enable the Bank to carry out the audit or inspection.
- For the purpose of obtaining evidence under oath in relation to an audit or inspection, the Bank of Canada has all the powers of a person appointed as a commissioner under Part II of the *Inquiries Act*.
- The Governor of the Bank of Canada may issue directives to the operator or participant of a designated system to cease or refrain from engaging in an act, omission or course of conduct that may result or is likely to result in systemic risk being inadequately controlled.

**United States**

- The Federal Reserve has the authority to charter, examine, regulate, enforce, compel disclosure of information, provide access to payment services, and/or to provide access to intra-day credit.

**United Kingdom**

- The Bank of England's powers with regard to designated systems can be classified into three categories: information-gathering powers, powers imposing requirements, and sanctions.

***Requirements for designated systems*****Canada**

- Under CP Act, operators of designated payment systems have to send a copy of every rule governing them to the Minister of Finance. The rule will not come into force before the 30th day after a copy has been sent to the Minister unless the Minister declares that the rule is in force prior to that day.
- Under the PCSA, designated clearing and settlement systems must comply with the CPSS core principles for systemically important systems.

**United States**

- Designated clearing and settlement systems must comply with the CPSS core principles for systemically important systems.

**European Union**

- Large-value payment systems must comply with the CPSS core principles for systemically important systems
- Retail payment systems
  - Retail systems of systemic importance must comply with all the core principles.
  - Retail systems of prominent importance must comply with six selected core principles.
  - Other retail systems must comply with other applicable standards.
- The Euro System has developed a generalized approach and a minimum set of common oversight standards for payment instruments.

**United Kingdom**

- Designated systems must comply with the CPSS core principles for systemically important systems, plus the following four principles developed by the Bank of England:
  - The system should manage its business risks so that its users can rely on continuity of its services.
  - The system should regularly review the risks it bears from, and poses to, other infrastructures as a result of interdependencies, and implement controls adequate to manage those risks.
  - The system should understand and manage risks that are brought to the system as a result of participants' relationships with indirect participants.
  - The system should manage its outsourced relationships prudently, ensuring that contractual and risk management arrangements are clear, appropriate and robust.

## *Authentication*

Purpose: To establish how to identify a person making the payment.

### **Canada**

- Credit and debit cards use a two-tier authentication method—something you have, a card, and something you know, a PIN. Both the debit and credit card networks are moving to the Chip & PIN technology. The chip technology is based on the global EMV standard. Exceptions exist (e.g., for PIN-less debit and online transactions).
- Prepaid cards have no authentication process in place. A message on the cards encourages users to treat them as cash because if a card is lost, anyone can use it.

### **United States**

- For credit cards, signatures are used. For debit cards, signatures are used for some and PINs for others.

### **European Union**

- Debit cards: Chip & PIN
- Online transactions: Moving toward two-factor authentication methods (e.g., ID and password)
- Directive 99/93/EC provides a framework for electronic payments.

## *Participation in clearing*

Purpose: To ensure that institutions meet minimum standards and have the technical competence to access high-volume clearing.

### **Canada**

- Automated Clearing Settlement System (ACSS): The ACSS can only be accessed directly by direct clearers or by the Bank of Canada. Other members in the payments system that require clearing of paper or electronic items do it as indirect clearers using the services of a direct clearer.
- Direct clearers must have established and must maintain a settlement account and a loan facility with the Bank of Canada, have payment items volume of no less than 0.5% of the total national volume and meet technical and financial requirements.
- Large Value Transfer System (LVTS): The LVTS can only be accessed directly by direct participants or by the Bank of Canada. Others (financial institutions, corporate clients, etc.) can use the LVTS using the services of a direct participant.
- Direct participants must have established and must maintain a settlement account with the Bank of Canada, have entered into any agreements that may be required by the Bank of Canada governing the settlement of multilateral net position, the provision by the Bank of Canada of advances for LVTS and the pledging of collateral to secure those advances and any other agreement the Bank of Canada may require. Direct participants must also meet the technical requirement and pay an admission fee and may, depending on whether or not they have contributed to the development cost of the system, also have to pay a share of the development cost of the system.
- Credit card networks: Transactions are cleared by the credit card networks, and the resulting positions are settled through the LVTS.
- Debit card payments: Interac transactions at point-of-sale and online are cleared through the ACSS.

**United States**

- Participants in the Clearing House Interbank Payments System (CHIPS) must be commercial bank institutions or *Edge Act* institutions.
- Individuals, corporations or other entities that through agreements with an originating depository financial institution (ODFI) may initiate entries in the Automated Clearing House (ACH) network.
- ODFIs originate ACH entries at the request of and by ODFI agreements with its customers.

**United Kingdom**

- Bankers Automated Clearing Services (BACS) settlement members consist of the Bank of England, a dozen commercial banks and one building society. Settlement members can sponsor users of the service who can access the system directly, in addition to other users (around 60,000 of them) who access the system indirectly.
- Clearing House Automated Payment System (CHAPS) settlement members are responsible for settling all transfers and, consequently, all interbank obligations. Other financial institutions can access CHAPS indirectly through the settlement members. Bank customers may also route urgent payments through CHAPS.

***Participation in settlement***

Purpose: To ensure that institutions participating in settlement have the financial strength and competence required to ensure effective settlement.

**Canada**

- ACSS: The ACSS can be accessed directly only by direct clearers or by the Bank of Canada. Other members in the payments system settle their positions directly with the direct clearer they use to access the ACSS.
- Direct clearers must have established and must maintain a settlement account and a loan facility with the Bank of Canada, have payment items volume of no less than 0.5% of the total national volume and meet technical and financial requirements.
- LVTS: The LVTS can be accessed directly only by direct participants or by the Bank of Canada. Indirect participants settle their position with the direct participant(s) whose services they use to access the LVTS. Direct participants must have established and must maintain a settlement account with the Bank of Canada, have entered into any agreements that may be required by the Bank of Canada governing the settlement of multilateral net position, the provision by the Bank of Canada of advances for LVTS and the pledging of collateral to secure those advances and any other agreement the Bank of Canada may require. Direct participants must also meet the technical requirement and pay an admission fee and may, depending on whether or not they have contributed to the development cost of the system, also have to pay a share of the development cost of the system.
- Credit card networks: Transactions are cleared by the credit card networks, and the resulting positions are settled through the LVTS.
- Debit card payments: Interac transactions at point-of-sale and online are settled through the ACSS.



**United States**

- The National Settlement Service (NSS) is provided by the Federal Reserve Banks for private-sector clearing arrangements, allowing them to settle on a multilateral basis through master settlement accounts held at the Federal Reserve Banks.
- Fedwire Funds Services: Depository institutions and some other financial institutions that hold an account with a Federal Reserve Bank are eligible to participate in the Fedwire Funds Services.

**United Kingdom**

- BACS settlement members consists of the Bank of England, a dozen commercial banks and one building society.
- Settlement members can sponsor users of the service who can access the system directly, in addition to other users (around 60,000 of them) who access the system indirectly.
- CHAPS settlement members are responsible for settling all transfers and, consequently, all interbank obligations. Other financial institutions can access CHAPS indirectly through the settlement members. Bank customers may also route urgent payments.

**Payment rules****Finality of payments**

Purpose: To provide payments providers and users with certainty that a transaction will not be unwound in the event that a participant in a clearing and settlement system were to fail.

**Canada**

- Payments made through the LVTS are final and irrevocable. The requirements of the LVTS are such that there is sufficient collateral to cover the failure of the largest net negative position in the system. In addition, the Bank of Canada guarantees that the LVTS will settle even if more than one participant were to fail during a given LVTS cycle.
- Point-of-sale electronic funds transfers and email payments (Interac) are final when the payment is settled.

**United States**

- Payments are final and irrevocable once they have been sent and received through either CHIPS or Fedwire.

**European Union**

- Transfer orders and netting are legally enforceable and, even in the event of insolvency, proceedings against a participant, are binding on third parties, provided that transfer orders were entered into a system before the moment of opening of such insolvency proceedings.<sup>14</sup>
- Payment orders cannot be revoked once transmitted or once the payee has given consent to transmit the payment order.

**Finality of settlement**

Purpose: To provide payments providers with legal certainty that a transaction will not be unwound once settlement has occurred.

**Canada**

- Where the settlement rules of a designated clearing and settlement system provide that the settlement of a payment obligation through an entry to or a payment out of an account of a participant, a clearing house or a central counter-party at the Bank [of Canada] is final and irrevocable, the entry or payment shall not be required to be reversed, repaid or set aside.<sup>15</sup>

**European Union**

- Transfer orders and netting shall be legally enforceable and, even in the event of insolvency proceedings against a participant, shall be binding on third parties, provided that transfer orders were entered into a system before the moment of opening of such insolvency proceedings.<sup>16</sup>

***Reversibility of payments***

Purpose: To allow reversibility of payments, provided that certain conditions are met, even in cases where the payment is considered to be final.

**Canada**

- The ACSS Rules provide for the return of many types of paper and electronic items through the clearing for immediate credit for a variety of reasons and for a limited time. Point-of-sale debits are irrevocable but may be reversed (e.g., in the case of an error).

***Recoverability of payments***

Purpose: To allow recoverability of payments, provided that certain conditions are met, even in cases where the payment is considered to be final

**Canada**

- In the law of Canada, the recoverability of payments is governed by other laws (e.g., laws on restitution and on *enrichissement sans cause*).

***Execution by beneficiary's bank***

Purpose: To provide payments providers and other users with legal certainty regarding the timing of the completion of transactions.

**Canada**

- The LVTS bylaws require funds to be made available to the payee no later than the end of the LVTS cycle.

**United States**

- Regulation E (*Electronic Fund Transfers*) and Article 4A of the *Uniform Commercial Code* do not prescribe a maximum time to execute a payment. They do, however, prescribe that a payment order may not be executed before the due date on the payment order.

**European Union**

- Member states require the payer's payment service provider to ensure that, after the point in time of receipt in accordance with Article 64 of the Payment Services Directive, the amount of the payment transaction is credited to the payee's payment service provider's account at the latest by the end of the next business day. Until January 1, 2012, a payer and his or her payment service provider may agree on a period no longer than three business days. These periods may be extended by a further business day for paper-initiated payment transactions.<sup>17</sup>

***Availability standards for networks to payment suppliers***

Purpose: To provide payment system participants with certainty with respect to the availability of networks.

**CPSS Core Principle VII**

The system should ensure a high degree of security and operational reliability and should have contingency arrangements for timely completion of daily processing.

**Clearing and settlement systems using SWIFT**

One of the high-level expectations for the oversight of the Society for Worldwide Interbank Financial Telecommunication (SWIFT) is reliability and resilience. Commensurate with its role in the global financial system, SWIFT is expected to implement appropriate policies and procedures, and devote sufficient resources, to ensure that its critical services are available, reliable and resilient and that business continuity management and disaster recovery plans support the timely resumption of its critical services in the event of an outage.<sup>18</sup>

**Canada**

- LVTS participants are required to have established procedures to ensure that their payment processing capabilities are available at least 98% of the time in any given 30-day period between 1 a.m. and the start of settlement for each LVTS cycle—if the participant is active from 1 a.m.—and otherwise between 8 a.m. and the start of settlement for each LVTS cycle.<sup>19</sup> The CPA requirement for its own availability is 99.5%.
- Contracts between payment service providers and the networks they use (if they do not own them) determine the obligations of availability and the penalties for default.

**European Union**

- One of the standards in the oversight framework for card payment schemes is that a card payment scheme should ensure an adequate level of security, operational reliability and business continuity.

**Protection of user interests**

(Users include consumers and merchants.)

***Minimum standards for the protection of users******Disclosure and transparency***

Purpose: To ensure that information about the terms and conditions governing payment instruments is readily accessible to users.

**Canada**

- Banks are required to provide in writing (which may be by way of an electronic form when the recipient agrees or by way of a website) for customers: an account agreement, information on all charges applicable to the account, information on how customers will be notified of increased charges or on new charges on the account and information on banks' procedures for complaints. These type of requirements, although not targeted directly at payment instruments, would apply to disclosures and transparency for cheques and debit cards.

- Other financial institutions are also subject to legislation and regulations (e.g., the *Credit Business Practices (Banks, Authorized Foreign Banks, Trust and Loan Companies, Retail Associations, Canadian Insurance Companies and Foreign Insurance Companies) Regulations*) that require similar levels of disclosure and transparency.
- The *Code of Conduct for the Credit and Debit Card Industry in Canada* outlines disclosures and requirements for payment card networks and their participants (e.g., merchant acquirers) toward acceptors of credit and debit cards (merchants).
- Some provinces have legislation in place to offer a minimum level of protection for consumers with regard to prepaid cards. For instance, in Quebec, the *Consumer Protection Act* requires issuers to explain the conditions applicable to the use of the prepaid cards and how to check the balance of the prepaid card. This can be accomplished by having the information printed on the card directly or by the merchant providing the information for the customer in writing. Most provinces have similar requirements.

### United States

- Regulation E sets out the required disclosures to be made by the financial institutions and states that those required disclosures are to be clear and readily understandable, in writing, and in a form that the consumer may keep.
- Federal Reserve rules require the disclosure of fees for gift cards
- *Credit Card Act* (2009) requires use of plain language in disclosures.

### European Union

- The PSD provides the minimum standards with regard to disclosure and transparency requirements between the payment service provider and the user.

### Recourse options

Purpose: To allow users to report issues encountered in making payments and to ensure that the issues will be investigated and appropriately resolved with minimal delay.

### Canada

- *Bank Act* and provincial statutes (credit unions and other deposit-taking financial institutions)—Requirement for procedures for dealing with complaints, the designation of a complaints body either internal or external to the financial institution (the Financial Consumer Agency of Canada [FCAC])
- Various codes of conduct and public commitments monitored by the FCAC
- *Canadian Code of Practice for Consumer Debit Card Services*
- *Code of Conduct for the Credit and Debit Card Industry in Canada*—cheque holds, fraud protection in relation to credit cards, low-cost accounts, online payments, etc.

### United States

- Regulation E sets out procedures for resolving errors in electronic fund transfers.
- Article 4A establishes where liability lies in cases of erroneous payment orders.

### European Union

- The PSD provides basic recourse rights for users.

***Fees and charges (including allocation among parties)***

Purpose: To determine the allocation of fees and charges among payment system users.

**Canada**

- Canada does not go beyond requiring the disclosure of fees; it does not control the amount that may be charged in any system.
- **Cheques:** Payers' and payees' fees are either assessed as part of their monthly bank account plan charges or on a per-transaction basis under a contractual agreement with the financial institution.
- **Debit cards at point-of-sale through the Interac network:** Fees related to the transactions are paid by the merchant at the source (the merchant's account is credited for a portion of the value of the total transaction). There is no interchange fee for a debit card transaction, the merchant fee is around \$0.12, and the switch fee paid by the acquirer and the issuer is \$0.0073 each. Payers also pay fees for this service either through their monthly bank account charges or on a per-transaction basis. Interac is subject to a Consent Order from the Competition Tribunal which prescribes a not-for-profit status.
- **Credit cards:** Fees related to the transactions are paid by the merchant at the source (the merchant is credited for a portion of the value of the total transaction). Those fees are then distributed between the issuer (gets the interchange fee) and the merchant acquirer (gets the merchant fee minus the interchange fee). Both the acquirer and the issuer then pay switch fees to the network for settlement services. Payers do not pay a transaction fee when they use credit cards.
- The fee structure is governed by a contractual agreement between the merchants and the merchant acquirers.
- The voluntary code of conduct for credit and debit card networks outlines the requirements for merchant acquirers with regard to pricing transparency, as well as with regard to the time frame for the implementation of fee changes.
- **Preauthorized debit:** Payers' and payees' fees are either part of their monthly bank account plan charges or on a per-transaction basis under a contractual agreement with the financial institution.
- **Prepaid cards:** Provincial statutes limit the fees to cardholders. For instance, British Columbia's *Prepaid Purchase Cards Regulation* outlines the circumstances under which a supplier of prepaid cards may charge fees.
- **Equipment:** Merchants that accept debit cards, credit cards, prepaid cards and/or any other non-paper-based payment instruments need to either purchase the equipment required to process those payments or rent the equipment from their acquirer.

**United States**

- **Debit cards:** *Federal Reserve Board Regulation II* sets the maximum interchange fee for debit transactions. Regulation II will take effect on October 1, 2011.
- **Prepaid cards:** The *Dodd-Frank Wall Street Reform and Consumer Protection Act* grants the Federal Reserve the authority to set interchange fee rules on prepaid cards subject to certain guidelines.
- Federal Reserve rules limit fees on gift cards. Fees can be charged directly to the remaining balance on the card if the card has not been used for at least one year, and only one fee can be charged per month.

**European Union**

- Under the PSD, the payer and the payee each pay their own service providers.

**Australia**

- The Reserve Bank of Australia has been mandated with the oversight of interchange fees. The interchange fee standard requires that the fees paid by transaction-acquiring institutions to card-issuing institutions be no higher than cost-based benchmarks.
- Merchants are permitted to impose a charge on consumers who pay with credit cards.

***User access to a basic means of payment***

Purpose: To ensure that adequate services are available on reasonable terms independent of a users' socio-economic and demographic circumstances.

**Canada**

- The *Bank Act* allows the Governor in Council to make regulations requiring banks to offer low-cost banking accounts. The government has signed an agreement with some financial institutions providing guidelines as to what those low-cost retail accounts should include. These guidelines include cheque-writing privileges (although some additional costs may apply), a debit card and between 8 and 15 debit transactions per month, at least 2 of which can be made in-branch.

**United States**

- New York State mandates basic-needs bank accounts, but the provisions do not mention debit cards as part of those accounts.

**United Kingdom**

- Basic bank accounts established under a government scheme allows for receipt of wage benefits and state pensions and a withdrawal card.

***Liability for unauthorized transactions***

Purpose: To provide clarity on where liability rests with respect to unauthorized transactions.

**Canada**

- Many payment card providers have set zero-liability rules for consumers who are victims of unauthorized transactions following circumstances beyond their control (e.g. Interac, Visa and MasterCard). However, the liability might not necessarily be borne by the issuing entity if the party who accepted the instrument for payment did not perform enough due diligence to ensure the authenticity of the payment instrument and of its user.

**United States**

- Regulation E provides limits for consumers' liability in the case of a timely (two business days) notice given, as well as in the case where no timely notice was given. Article 4A outlines how to establish where the liability lies in cases of erroneous payment orders.
- For credit card transactions, the *Truth in Lending Act* limits consumer liability to \$50 if a credit card is stolen, lost, or used without the holder's authorization.

**European Union**

- Unauthorized payment transactions are to be refunded in full by the payment service provider to the account holder. The account holder must inform the payment service provider as soon as possible that an unauthorized transaction was executed. In the case of a lost or stolen payment instrument, the payer is liable for up to €150.

***Liability for mistaken transactions***

Purpose: To provide clarity on where liability rests with respect to mistaken transactions.

**Canada**

- The liability for mistaken transaction does not reside with the network. For instance, if a direct debit transaction using Interac is debited twice from the customer's account, the customer must contact his or her financial institution to resolve the issue. If the customer used a credit card, then he or she must contact the issuer of the credit card. This liability arrangement is based on contractual arrangements.

**United States**

- Regulation E sets out the procedures to be followed if an error is reported by the consumer.

**European Union**

- A payer is entitled to a refund from a payment service provider of an authorized payment transaction initiated by or through a payee which has already been executed, if the following conditions are met:
  - The authorization did not specify the exact amount of the payment transaction when the authorization was made; and
  - The amount of the payment transaction exceeded the amount the payer could reasonably have expected taking into account his or her previous spending pattern, the conditions in his or her framework contract and relevant circumstances of the case.
  - At the payment service provider's request, the payer shall provide factual elements relating to such conditions. The refund consists of the full amount of the executed payment transaction.<sup>20</sup>

***Service standards***

Purpose: To assure users of the availability of payment services over time.

**Canada**

- Debit cards: Subject to network rules
- Credit cards: Network standards for service

***Execution time: Payment users***

Purpose: To give certainty to payment users as to the time required for the completion of transactions.

**Canada**

- The time varies between payment instruments. There is no standard or maximum execution time.

**United States**

- Regulation E and Article 4A do not prescribe a maximum time to execute a payment. They do, however, prescribe that a payment order may not be executed before the due date on the payment order.

### European Union

- Member states shall require the payer's payment service provider to ensure that, after the point in time of receipt in accordance with Article 64, the amount of the payment transaction is credited to the payee's payments service provider's account at the latest by the end of the next business day. Until January 1, 2012, a payer and his or her payment service provider may agree on a period no longer than three business days. These periods may be extended by a further business day for paper-initiated payment transactions.<sup>21</sup>

### Availability of funds

Purpose: To provide users with certainty as to the timing between the receipt by their payments institutions and their availability to the users.

### Canada

- Banks are required under the *Cheque Holding Policy Disclosure (Bank) Regulations* to have a policy on holding periods for cheques. Banks have also put in place a voluntary commitment on reduced cheque hold periods which, subject to some conditions, currently limits the hold period to seven business days (applies to most circumstances).
- All banks are required to cash Government of Canada cheques for free (subject to presentation of proper identification credentials and for cheques of a maximum value of \$1,500).
- Debit cards: Funds are available next banking day.
- Credit cards: The availability of funds to merchants is determined by card association rules.

### United States

- Funds must be made available the business day following deposits for the following type of instruments: cash (deposited in person); electronic payments; U.S. Treasury cheques; U.S. Postal Service money orders; Federal Reserve Bank and Federal Home Loan Bank cheques; state or local government cheques; cashier's, certified or teller's cheques; cheques drawn on an account held in the same institution where it is deposited; the first \$100 of non-next-day cheques must be made available then next day.
- Funds must be made available the second business day following the deposit of a local cheque (other than those discussed above).
- Funds must be made available the fifth business day following the deposit of a non-local cheque (other than those discussed above).

### United Kingdom

- Cheque & Credit Clearing Company 2-4-6 timescales
  - Specifies that interest is paid on a deposited cheque after two days and that the depositor can withdraw the funds on the fourth day. After the sixth day, the depositor "can be certain that the cheques will not bounce and the money cannot be reclaimed from the company account without his consent."

### European Union

- Payees are to receive credit for funds transferred to them on the same business day the funds are received by the payments service providers. The funds are to be at the payees' disposal as soon as they are debited. The date on debited transactions is to be no earlier than the date they are debited from the payments account.



***Preauthorized payments***

Purpose: To establish safeguards with regard to preauthorized access.

**Canada**

- Preauthorized debits that require the clearing and settlement of the transactions through the ACSS are required to conform with Rule H1, which requires that billers give customers at least 10 days' notice for variable-amount preauthorized debits, unless waived by mutual agreement. It also requires that preauthorized debit agreements specify the payment frequency (e.g., monthly).
- Preauthorized payments through other instruments are not covered by CPA Rule H1 but by other network rules and/or guidelines (e.g., Visa, MasterCard or American Express, in the case of preauthorized payments by credit cards).

**United States**

- In the case of a regular (at least once every 60 days) preauthorized transfer to a consumer account, the financial institution is required to give notice to the consumer that the transfer has taken place unless the payer gives notice to the consumer that the transfer has been initiated.
- A preauthorized transfer from a consumer account needs to be authorized in writing (including signature) by the consumer. If the amount of the transfer varies, either the financial institution or the payee needs to inform the consumer at least 10 days before the scheduled date of transfer.

**European Union**

- The PSD provides minimum standards as to the arrangements for preauthorized recurring payments (e.g., recourse, information disclosure, etc.).

***Credit of full amount***

Purpose: To provide certainty that the amount received by the payee is the same as the amount paid by the payer.

**Canada**

- LVTS—the guideline is to credit the full amount.

**European Union**

- The PSD requires that payees receive the full amount of the payment and that no charge be deducted from that payment.
- If the payee is to pay fees to the service provider, and if both parties agree, the amount can be deducted from the incoming funds but must be done separately.

***Finality of payment: Users***

Purpose: To assure receivers of payments that the payment will not be reversed. Finality of payments does not prevent refund or compensation for mistaken or unlawful transactions.

**Canada**

- Subject to network and system rules.

**United States**

- Payments sent through Fedwire are final and irrevocable when the amount of the payment order is credited to the receiving participant's account or when notice is sent to the receiving participant.
- CHIPS provides real-time settlement for payment orders as they are released from the CHIPS payment queue during the operating day.

**European Union**

- Transfer orders and netting shall be legally enforceable and, even in the event of insolvency proceedings against a participant, shall be binding on third parties, provided that transfer orders were entered into a system before the moment of opening of such insolvency proceedings.<sup>22</sup>
- Payment orders cannot be revoked once transmitted or once the payee has given consent to transmit the payment order.

***Reversibility of payments***

Purpose: To allow reversibility of payments if certain given conditions are met, even in the case where the payment is considered to be final.

**Canada**

- The CPA's payments rules do not specify conditions under which transactions can be reversed for end users. Institutions can reverse payments on behalf of users in certain cases.
- Interac payments are not reversible.
- The reversal of credit card payment is subject to network rules.

***Security******Privacy of information***

Purpose: To protect the confidentiality of any information about users held by payments service suppliers or while transmitted.

**Canada**

- The *Personal Information Protection and Electronic Documents Act* outlines the requirements in matters of protection of confidentiality of any information about users, in the absence of provincial regimes.
- Cheques: An industry-wide security standard was developed to ensure the security of cheque imaging. The standard ensures that the images are captured, transmitted and stored in a secure environment and that an audit trail is maintained.
- Credit card networks require that new terminals not print on customer receipts the expiry date of the card or the digits of the card number (except for the last four).

**United States**

- *Federal Reserve Board Regulation P* outlines the obligations of financial institutions to provide notice to their customers about their privacy policies and practices and the right of consumers to prevent a financial institution from disclosing non-public personal information about them to non-affiliated third parties by "opting out" of that disclosure.
- Credit cards networks require that new terminals not print on customer receipts the expiry date of the card or the digits of the card number (except for the last four).

**European Union**

- The PSD requires payment service providers to make sure that the personalized security features of the payment instrument are not accessible to parties other than the payment service user entitled to use the payment instrument.
- One of the standards in the oversight framework for card payment schemes is to ensure the scheme has an adequate level of security, operational reliability and business continuity.

***Security of value in payment processes***

Purpose: To protect users' value from processing errors and malfunctions.

**Canada**

- Chip & PIN was recently adopted in Canada for both debit and credit cards (industry standard). For cheques, the signature on the cheque is to be verified against the signature on file at the financial institution, although this is not commonly done.

**United States**

- Article 4A states that comparison of a signature on a payment order or communication with an authorized specimen signature of the customer is not by itself a security procedure.

**European Union**

- One of the standards in the oversight framework for card payment schemes is to ensure that a scheme has an adequate level of security, operational reliability and business continuity.

***Evidence law***

Purpose: To increase the reliability of the proof of payment without undue formality.

**Canada**

- The digital images of cheques taken by banks carry the same legal status as the original cancelled cheque, unless the original cheque still exists.

**United States**

- Check 21 reduced barriers to the electronic collection of cheques and electronic cheques.

***Portability of payment accounts*****Canada**

- Governed by practices of financial institutions.

**United Kingdom**

- Outgoing payments (direct debits and standing orders) are transferred automatically when customers shift their accounts. The Payments Council has signalled its intention to make sure that incoming payments are properly switched to the customer's new account.

**Netherlands**

- Interbank Switch Support System facilitates moving accounts from one institution to another. It allows for the rerouting of direct debit and credit transactions. Initiators of direct debits are informed automatically of the new account number, but customers must inform creditors of the change.

## Efficiency and competition

### *Competition policy*

Purpose: To maintain competitive conditions in payments markets (including new entry).

#### **Canada**

- The Competition Bureau and the Competition Tribunal are responsible for competition issues.
- The approval of the Minister of Finance is needed for federal financial institutions.
- Fees are unregulated.

#### **United States**

- Responsibility for review of bank mergers is divided among the Department of Justice, the Federal Reserve, the Office of the Comptroller of Currency, the Office of Thrift Supervision and the Federal Deposit Insurance Corporation (FDIC).
- Federal Reserve has the power to regulate interchange fees on debit card transactions.

#### **European Union**

- Member states shall ensure that the rules on access to payment systems of authorized or registered payment service providers that are legal persons shall be objective, non-discriminatory and proportionate and that those rules do not inhibit access more than is necessary to safeguard against specific risks such as settlement risk, operational risk and business risk and to protect the financial and operational stability of the payments system.
- Competition authorities have reached an agreement with card networks with respect to the level of some fees.

### *Participation in networks*

#### *Participation in clearing and settlement networks*

Purpose: To ensure that the rules governing participation are objective, non-discriminatory and proportionate, with access restricted no more than necessary to safeguard specific risks and to protect financial and operational stability.

#### **Canada**

- CPA clearing and settlement:
  - CPA: Direct access is limited to direct clearers (ACSS) and direct participants (LVTS). Indirect access (i.e., using the services of a direct clearer or participant) is open to CPA members that have an agreement in place with at least one of the direct clearers or participants to act as its agent for ACSS or LVTS purposes.
  - Banks and authorized foreign banks, as well as the Bank of Canada, are required to be members of the CPA. In addition, other institutions are eligible to become CPA members, including cooperative credit associations, loan companies, trust companies, life insurance companies, securities dealers and money market mutual funds. Enterprises promoting the most innovative systems (such as PayPal and Zoompass) are ineligible.

- Credit cards:
  - Issuers must be regulated financial institutions.
  - Acquirers must be affiliated with a regulated financial institution (with one exception).

### **United States**

- Access to the Clearing House Interbank Payments System (CHIPS). Participants in CHIPS must be commercial bank institutions or *Edge Act* institutions.
- Access to the ACH is available to individuals, corporations or other entities that, through agreements with an originating depository financial institution (ODFI), may initiate entries in the ACH network. ODFIs originate ACH entries at the request of, and by ODFI agreements with, its customers.
- The National Settlement Service (NSS) is provided by the Federal Reserve Banks for private-sector clearing arrangements, allowing them to settle on a multilateral basis through master settlement accounts held at the Federal Reserve Banks.
- Fedwire Funds Services: Depository institutions and some other financial institutions that hold an account with a Federal Reserve Bank are eligible to participate in the Fedwire Funds Services.
- Issuers and networks of debit cards are prohibited from inhibiting a merchant's ability to direct the routing of the electronic debt transaction over any network that the issuer has enabled to process them (effective October 1, 2011).

### **Australia**

- Credit cards
  - Non-bank members in Visa/MasterCard.
  - Merchants can be self-acquirers.

### ***Participation in debit card networks***

Purpose: To ensure that participation rules are objective, non-discriminatory and proportionate, with access restricted no more than necessary to safeguard specific risks and to protect financial and operational stability.

### **Canada**

- Interac
  - Since Interac transactions clear through the ACSS, issuers must be members of the CPA.
  - Acquirers include financial institutions and other payment service providers.
  - In order to accept Interac (debit services at point-of-sale), merchants must have a contract with a merchant acquirer.

### **United States**

- Regulation E stipulates that financial institutions may only issue a debit card if the account holder has requested it.
- Regulation E also applies to debit card issuers that are not financial institutions.

### ***Participation in credit card networks***

Purpose: To ensure that participation rules are objective, non-discriminatory and proportionate, with access restricted no more than necessary to safeguard specific risks and to protect financial and operational stability.

**Canada**

- Visa and MasterCard typically require issuers and merchant acquirers to be financial institutions or to be sponsored by one (one temporary exception at present).
- Amex serves as acquirer and issuer, in addition to being the network operator.
- Merchants that want to accept credit cards must contract with merchant acquirers.

**Australia**

- Specialist credit card institutions, authorized and supervised by the Australian Prudential Regulation Authority can apply to access the networks either as acquirers or as issuers.

***Issuance of e-money*****European Union**

- Institutions that want to issue electronic money must first obtain a licence.

***Issuance of payments instruments******Issuance of gift cards (closed-loop)***

Purpose: To ensure that restrictions on card issuance are no more than needed to meet obligations arising from customer payments.

**Canada**

- Some provinces have statutes addressing other features of gift cards, disclosure, termination, etc., but the issuance of gift cards themselves is unregulated.

**United States**

- Covered under Regulation E.

***Issue of electronic instruments***

Purpose: To ensure that restrictions on card issuance are no more than needed to meet obligations arising from customer payments.

**European Union**

- The Electronic Money Directive on the taking up, pursuit and prudential supervision of the business of electronic money institutions outlines requirements for an entity to be granted the authorization to issue e-money (e.g., initial capital requirement, minimum levels of own funds). The directive also prescribes the type of other activities that an electronic money issuer is entitled to enter into.

## *Sources for the taxonomy*

### **United States**

Federal Reserve website

[www.federalreserve.gov](http://www.federalreserve.gov)

Federal Reserve Regulation E: Electronic fund transfers

[www.federalreserve.gov/bankinfo/reglisting.htm#E](http://www.federalreserve.gov/bankinfo/reglisting.htm#E)

Federal Reserve Regulation CC: Availability of Funds and Collection of Cheques

[www.federalreserve.gov/bankinfo/reglisting.htm#CC](http://www.federalreserve.gov/bankinfo/reglisting.htm#CC)

Federal Reserve Policy on Payment System Risk

[www.federalreserve.gov/paymentsystems/psr\\_policy.htm](http://www.federalreserve.gov/paymentsystems/psr_policy.htm)

NACHA – The Electronic Payments Association website

[www.nacha.org](http://www.nacha.org)

Federal Deposit Insurance Corporation—Changes in FDIC Deposit Insurance Coverage website

[www.fdic.gov/deposit/deposits/changes.html](http://www.fdic.gov/deposit/deposits/changes.html)

U.C.C. - Article 4A – Funds Transfer website

[www.law.cornell.edu/ucc/4A](http://www.law.cornell.edu/ucc/4A)

### **Canada**

*Bank Act* and Regulations made under the *Bank Act*

[www.laws.justice.gc.ca/eng/acts/B-1.01/index.html](http://www.laws.justice.gc.ca/eng/acts/B-1.01/index.html)

Bank of Canada website

[www.bankofcanada.ca](http://www.bankofcanada.ca)

*Canadian Payments Act*

[www.laws.justice.gc.ca/eng/acts/C-21/index.html](http://www.laws.justice.gc.ca/eng/acts/C-21/index.html)

Canadian Payments Association website

[www.cdnpay.ca](http://www.cdnpay.ca)

Canadian Bankers Association website

[www.cba.ca](http://www.cba.ca)

*Code of Conduct for the Credit and Debit Card Industry in Canada*

[www.fin.gc.ca/n10/data/10-049\\_1-eng.asp](http://www.fin.gc.ca/n10/data/10-049_1-eng.asp)

Consumers and Debit Cards—*Canadian Code of Practice for Consumer Debit Card Services*

[www.fcac-acfc.gc.ca/eng/industry/obligation/codeCond/debitCardCode-eng.asp](http://www.fcac-acfc.gc.ca/eng/industry/obligation/codeCond/debitCardCode-eng.asp)

Financial Consumer Agency of Canada

[www.fcac-acfc.gc.ca](http://www.fcac-acfc.gc.ca)

*Payment Clearing and Settlement Act*

[www.laws.justice.gc.ca/eng/acts/P-4.4/index.html](http://www.laws.justice.gc.ca/eng/acts/P-4.4/index.html)

*Payment Card Networks Act*

[www.laws.justice.gc.ca/eng/acts/P-4.3/index.html](http://www.laws.justice.gc.ca/eng/acts/P-4.3/index.html)

### **Europe**

Payment Services Directive

[eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:319:0001:01:EN:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:319:0001:01:EN:HTML)

## Electronic Money Directive

[eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32009L0110:EN:NOT](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32009L0110:EN:NOT)

## Settlement Finality in Payment and Securities Settlement Systems Directive

[eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31998L0026:EN:NOT](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31998L0026:EN:NOT)

## Community Framework for Electronic Signatures

[eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31999L0093:EN:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31999L0093:EN:HTML)

## Regulation on Information on the Payer Accompanying Transfers of Funds

[eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32006R1781:EN:NOT](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32006R1781:EN:NOT)

## European Central Bank website

[www.ecb.eu](http://www.ecb.eu)

European Central Bank. 2008. Oversight Framework for Card Payment Schemes – Standards. January.

[www.ecb.eu/pub/pdf/other/oversightfwcardpayments200801en.pdf](http://www.ecb.eu/pub/pdf/other/oversightfwcardpayments200801en.pdf)

European Central Bank. Tom Kakkola Editor. 2010. “The Payment System: Payments, Securities and Derivatives, and the Role of the Eurosystem.” September.

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[http://www.nbb.be/doc/ts/enterprise/activities/oversight/FSR\\_2007EN\\_oversight%20of%20SWIFT\\_article%20HLEs.pdf](http://www.nbb.be/doc/ts/enterprise/activities/oversight/FSR_2007EN_oversight%20of%20SWIFT_article%20HLEs.pdf)

Great Britain. *Banking Act 2009*

[www.opsi.gov.uk/acts/acts2009/pdf/ukpga\\_20090001\\_en.pdf](http://www.opsi.gov.uk/acts/acts2009/pdf/ukpga_20090001_en.pdf)

## Bank of England website

<http://www.bankofengland.co.uk>

## European Payments Council

<http://www.europeanpaymentscouncil.eu/index.cfm>

HM Treasury. 2009. *The Recognition Process for Inter-Bank Payment Systems: A Guidance Note*. August.

[http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/d/bankingact\\_guidancenote\\_040809.pdf](http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/d/bankingact_guidancenote_040809.pdf)

**Other**

## Reserve Bank of Australia website

[www.rba.gov.au](http://www.rba.gov.au)

## Bank for International Settlements website

[www.bis.org](http://www.bis.org)

Bank for International Settlement, Committee on Payment and Settlement Systems. 2001. *Core Principles for Systemically Important Payments Systems*. CPSS Publication No. 43. January.

[www.bis.org/publ/cpss43.htm](http://www.bis.org/publ/cpss43.htm)



## Annex C3: Scope—Defining payments providers

As noted in the body of this paper, the new legislative framework would be founded on a broad definition of the payments industry. At the heart of the legislation would be a definition of a payments service provider that would seek to include all relevant players in the industry. Consideration should be given to exempting some systems that are either not available directly to the public or that are already sufficiently regulated.

To help the Task Force develop an appropriate definition of a payments service provider, the Regulatory Advisory Group examined what type of organizations should be included within the scope of the legislation. Although there were differences of opinion on who should be “in” and who should be “optional,” the discussion was informative. The following summarizes the consensus view on the question of scope. The discussion underscored the need for any legislation defining the scope of the payments industry to include flexibility to change the definition in regulations. As well, the legislation should allow the inclusion of firms that do not meet the legal definition but that are considered part of the industry, as well as the exclusion of firms that are considered marginal or outside the industry.

The table reflects the views of the Regulatory Advisory Group, not necessarily those of the Task Force.

**Table C5: Payments participants—Potential status**

Payments participant	Example	Status*
<b>Payment networks</b>		
Clearing and settlement	Canadian Payments Association(ACSS, LVTS, USBE)	In
	CLS Bank	In
	CDCC, CDSX	Not Sure
Credit card	Visa, MasterCard	In
	Amex (closed-loop)	In
Debit card	Interac, Acxsys (e-transfer), The Exchange	In
Other	PayPal (account to account)	In
	Blackhawk Network (network for prepaid/gift cards)	In
<b>Balance holders</b>		
Deposit-taking institutions	Banks, credit unions, etc. (if transactions are permitted from accounts)	In
Credit card issuers	Capital One, other payments service providers offering payments based on lines of credit	In
Online prepaid/account-based services	PayPal, Zoompass	In
Prepaid debit cards	Visa, MasterCard, MoneyMart Titanium,	In
Gift/prepaid cards—Multi-use	Shop! Card	In (depending on scale)

Payments participant	Example	Status*
Gift/prepaid cards—Single-use	Presto, Tim Hortons, Starbucks, Home Depot, Chapters, Esso	Optional
<b>Virtual currencies and points</b>		
Virtual money	Facebook Credits, Bitcoins	In
Loyalty point programs	Airmiles, Aeroplan	In
<b>Acquirers and payments processors</b>		
Card-processing acquirers	Moneris, Chase Paymentech, Global Payments	In
	Independent sales organizations	In
Online payment processors	Paypal, Google Checkout	In
<b>Other service providers</b>		
Payroll processing	Ceridian	In (with reservations)
Bill presentment and payment	TelPay, epost	In
Money transfer agents	Western Union, Moneygram	In
ABM operators	Cash N Go, Frisco-ATM, unbranded ABM	In
Cheque processors	Intria, Symcor	Optional (if doing business solely as agents)
<b>Users and other stakeholders</b>		
Consumers	Public Interest Advocacy Centre, Consumers' Association of Canada, St. Christopher House	Optional
Retailers	Canadian Federation of Independent Business, Retail Council of Canada, Canada Restaurant and Foodservices Association	Optional
Telecommunications firms	Rogers, Bell, Telus	Optional (unless providing a payment service above)
Technology firms	SecureKey, G&D, Gemalto	Optional
Software firms	Intuit, Sage, FreshBooks	Optional
Professional associations	Chartered accountants, law societies, Association for Financial Professionals	Optional
Other	Canadian Standards Association, governments	Optional
* Status was classified as either In (required to be members), Optional (not required, but eligible, to be members) or Not Sure (arguments in both directions).		

## Annex C4: Implications of the governance model for legislation

The following points are drawn from the Governance Working Group's analysis of the implications of the recommended governance model for the proposed legislation.

### *Legislation in general*

As a complement to other existing legislation that shapes the Canadian financial sector and determines its public oversight, the new payments legislation would set a vision for the payments system and define and validate the importance of payments as an industry. Subject to a five-year sunset review, the legislation would:

- Have overarching objectives: Maintaining public trust by minimizing risks to stability, security and privacy; by ensuring access and user protection; and by fostering innovation and open competition.
- Define the payments industry and capture—allowing regulation if needed—the various payments industry participants, based on the risks arising from their functions and their relative importance; compel captured participants to be members of a self-governing organization.
- Create a public oversight body (POB) for the payments system and amend major components of the Canadian Payments Association (CPA), as recommended in *Policy Paper B: Governance* and *Policy Paper D: Infrastructure*.
- Leave public accountability, directive and residual powers with the Minister of Finance.
- Have no impact on the Bank of Canada's oversight responsibility for systemic stability of designated clearing and settlement systems (determined by the *Payment Clearing and Settlement Act*).

### *Legislative implications for institutions*

- The legislation creating the POB will need to be detailed.
- The POB will have directive and regulatory powers and will therefore require highly prescriptive language similar to the legislative detail that underpins other financial sector agencies such as the Office of the Superintendent of Financial Institutions and the Financial Consumer Agency of Canada.
- Similarly, if the CPA is remodelled to provide a common payments platform that does not unfairly benefit one set of stakeholders, it will require a clear mandate, and governance and operational models, which detailed legislation would provide.
- The SGO's mandate, governance, powers, ability to amend bylaws, etc., will have to allow for flexibility and adaptability over time, balanced with a desire to provide the federal government with levers for addressing public policy concerns.

### *Legislative implications for SGOs*

- To carry out its role in the payments ecosystem, the SGO will require the legitimacy and powers to coordinate the industry in determining a strategic direction for the payments system, as well as in setting and enforcing policies and standards.

- The legislation should allow SGO members to influence the form and function of the organization both when it is created and as the payments system evolves.
- Prescribing SGO characteristics in legislation would have trade-offs. It would provide greater public control over design elements, but it could cause organizational challenges and unresponsiveness to environmental change (e.g., board structure, mandate, membership base). Legislation covering the CPA exemplifies this double-edged sword:
  - On the one hand, the example of the global auditing oversight body the Public Interest Oversight Board shows one extreme where an industry can establish an SGO, but some public sector actors complain that there is no way to effectively influence it or to compel it to cooperate.
  - On the other hand, the Canadian Securities Administrators (CSA) recognition order for the Investment Industry Regulatory Organization of Canada (IIROC) reveals a highly detailed regime where regulators must approve most governance changes and IIROC outputs (rules, etc.).
- A good middle ground would be for the POB to play a similar role to that of the CSA by issuing a recognition order for the SGO that details its mandate, governance and self-regulatory powers (as well as the oversight relationship). This recognition order would be negotiated with the SGO board and could be amended more easily than legislation as the payments system evolves.

## Annex C5: Principles for the Canadian payments system

### Brief by the Consumer Advisory Group on the objectives of a National Payments Policy

#### *A – Three ideas for a policy*

The policy framework that the Task Force proposes is based on three simple ideas, which we believe must be the foundation of any successful payments system:

1. Participants must *trust* it;
2. Participants must be able to use it (*access* it), and
3. Participants must receive “*good value*.”

Our payments system processes the payments that we make and accept: it involves the way we transfer or receive our money. If Canadians don’t trust that system, they will avoid it. Trust is the most fundamental characteristic of a payments system. Without trust, people resort to using cash or hoarding gold.

A very trustworthy system that no one could use because it is too difficult to understand, too expensive or simply not available where and when participants need it would not be very helpful. A successful payments system must therefore also be accessible.

Once participants have access to a trustworthy payments system, they will also expect to receive “good value.” Thus the system should be efficient, both now and in the future: it must therefore also foster innovation. Examples around the world show that, in many areas, healthy competition among providers promotes efficiency in payments systems.

These three objectives form the core of what we suggest should be Canada’s National Payments Policy for the twenty-first century. They need, however, to be put in perspective and to be made more specific.

In order to do so, we have developed a statement for a National Payments Policy [see box C3, page 10]. The Policy is drafted in a way that is reminiscent of public policies defined by Parliament when it seeks to provide legislative guidance for the regulation of vital infrastructures in our society, such as telecommunications and broadcasting. We will now turn to the various elements of that statement, before addressing briefly some generic concerns.

#### *B – Payments within a broader context*

The introductory paragraph to the draft National Payments Policy is meant to establish the overarching motivation for creating a set of objectives governing the Canadian payments system. This System is simply vital to our economy and society. It should therefore evolve in a way that is most beneficial for Canada as a whole, a result which can be achieved only if it is efficient. This paragraph can thus be understood as stating the overall strategic objective for the system: furthering growth, wealth and welfare through an efficient payments system.

In order to achieve that strategic objective, more specific, operational objectives must be established, which are detailed in the following paragraphs and presented here *infra*.

Importantly, the National Payments Policy and its specific objectives apply to the payments system as a whole. Thus the Policy does not imply that each and every cog in the system should always be perfectly compliant with all its requirements, but that the System as a whole is compliant with the objectives.

The National Payments Policy is addressed to “participants.” We define this term as including all end-users, payment service providers and intermediaries: all who are involved in making, receiving or processing payments.

### ***C – Detailed provisions of the policy***

#### ***(a) Generate and maintain a high level of trust among participants by being demonstrably:***

In order to accomplish the overarching objective established in the introductory paragraph, certain conditions must be met. Crucially, the system must be worthy of trust, and so trust appears as the first of the more specific objectives to be attained.

“Trust” is a very broad notion. In order to clarify what is intended, eight sub-objectives are described, that specify what would make a payments system trustworthy.

#### ***(i) Financially stable and safe with regard to the level of risk created or incurred by participants;***

There can be no trust in a payments system if participants do not believe that their money is safe. So-called “safety and soundness” requirements are necessary in order to mitigate systemic risk. All participants that create meaningful risk should be regulated, but in a manner that is consistent with the level of risk they generate. Regulation that is too lax amplifies risk; when it is too stringent, however, it can hinder competition and innovation.

#### ***(ii) Fair, reasonable and proportionate in the assignment of costs, benefits, rights and responsibilities among all participants, taking into account all relevant factors, including the level of risk involved and the ability of participants to prevent and bear risk and costs;***

In recent years, a number of issues have emerged in Canada that have undermined the trust of many participants in the operation of the payments system. There has been uncertainty about the level of legal risk and liability that may arise in numerous situations. For example, there has been concern that those who generate risk, or are best placed to reduce it, might prefer to transfer it to weaker participants, rather than design safer systems: agreements imposed by financial institutions sometimes impose greater liability on consumers using debit cards than is warranted by the *Canadian Code of Practice for Consumer Debit Card Services*, which itself has not been updated to reflect new risk associated with PIN-less debit at the point of sale. There have also been reasons to believe that some price structures have been less than perfectly efficient, as the ongoing debate surrounding interchange fees abundantly illustrates. Trust could be regained if it could be demonstrated that benefits, costs and liabilities are fairly shared, in a way that is reasonable and proportionate, taking into account the situations of various types of participants. Striving for a fair regulatory and economic framework is an ambitious goal and must be seen as a dynamic process. But the experience of the past decade strongly suggests that if this effort is not made, some participants – perhaps many – will feel that they cannot trust the Canadian payments system to meet their legitimate needs.

*(iii) Operationally robust, and able to process payments in a timely and accurate manner;*

A payments system must imperatively be robust: it must be dependable, adaptable and, when necessary, able to withstand crises. These requirements must inform operational aspects, but they also apply to the system's financial resilience. This does not imply that all components of the payments system must always comply with the highest robustness requirements: rather, robustness must be assessed with regard to the seriousness of the impact a component's failure would create.

While robustness also entails the system being available, it will not be trustworthy unless it is also able to process payments without mistakes or undue delay: Participants rely on resilience, accuracy and timeliness.

*(iv) Secure and able to protect the integrity and privacy of information;*

There is no need to belabour the necessity for the Canadian payments system to be secure and able to provide a high level of protection for personal information and important business data.

*(v) Supported by easily accessible and understandable rules governing its use, the prices charged to participants and the information provided thereto;*

For markets to function well and for participants to trust in their operation, clear and reliable information must be available. Participants should be able to determine and understand their rights and their responsibilities, including the prices they are likely to pay. Subparagraph (a)(ii) requires that the market work fairly, while subparagraph (a)(v) requires that appropriate information be made available to participants so that they can ascertain that it does.

*(vi) Held in compliance with appropriate regulatory oversight by public agencies and authorized self-governance organizations;*

In order to minimize the various risks attached to payments, rules are needed. Effective compliance oversight prevents problems and bolsters trust. The governance framework recommended by the Task Force envisions that part of that oversight would be entrusted to a public body, while the industry would be expected to ensure that the self-governance requirements it implements are followed by market participants.

*(vii) Supported by easily understandable, impartial and accessible systems of redress that are responsive and efficient and that include independent appeal processes; and*

Even so, disagreements will occur between individual participants. If they cannot be addressed satisfactorily, some may come to feel that they cannot trust that they will be justly treated. Impartial and efficient redress must therefore be easily accessible. And while many providers have already made efforts to implement internal processes in order to address grievances, there is also a need for independent mechanisms to which their decisions can be appealed and which, by their mere existence, foster trust in the payments system because participants will feel that, if necessary, their problem can be tackled by independent bodies that will transparently and fairly consider their complaint and decide what is just.

- (viii) *Governed in a way that provides all categories of participants with a reasonable opportunity to provide input into its governance, development and use;*

Finally, the experience of the past decade has shown that many categories of participants in the payments system need to have a say in how it evolves in order to defend their interests. Since decisions made by various providers have a direct impact on the services they can access, their rights and liabilities and the prices they pay, participants want their input to be considered as early as possible. Ensuring that the concerns of all categories of participants can be fairly addressed in a timely fashion would do much to enhance trust in our payments system, an issue we develop in *Policy Paper B*.

- (b) *Be easily accessible to all participants who use payment mechanisms and supportive of a reasonable expectation that they can choose amongst adequate payment mechanisms by ensuring:***

The most trustworthy system is useless if participants cannot benefit from its services. Accessibility must therefore be a core concern for everyone involved in the evolution of the Canadian payments system. Every Canadian should at least have access to a variety of basic payment mechanisms. That ideal must be tempered by reasonable expectations. For instance, mobile phone payments may not be available in the remotest parts of Northern Canada, where mobile communication services are not deployed. Still, within reason, all should have access to diverse payment mechanisms in order to make or receive payments.

- (i) *The provision of adequate and efficient services throughout Canada;*

The sheer size and geographical diversity of the country raise significant challenges. While payment through cash or cheque is currently available everywhere, the transition to digital payments will require those challenges to be tackled if Canadians are to be convinced to migrate to these new, more efficient payment mechanisms.

- (ii) *The delivery of adequate and affordable services that are available independently of participants' socio-economic and demographic circumstances or commercial significance; and*

- (iii) *Providing services that are easy to use and that accommodate participants of all skills and abilities;*

In the process of migrating toward digital payments, no Canadian should be left behind, whatever their financial situation, their age, their level of literacy or other abilities, or their origins. Nor should any business or other type of undertaking be left behind because of its size or similar considerations. Any new payment mechanism must therefore strive to accommodate all Canadians regardless of geographic location, ethnicity, language, skill or ability.

Most Canadians today do have access to a variety of traditional payment mechanisms. The challenge is to maintain and improve on that good record.



**(c) Provide good value by:**

- (i) *Operating in a way that delivers the most efficient costs to participants, consistent with the objectives of the national payments policy;*

Once Canadians have access to a payments system they can trust, they will naturally want to receive good value from that system. As indicated in the introductory paragraph to the statement of objectives, the Canadian payments system must be efficient. Healthy competition will foster innovation and both will drive efficiency and provide the greatest variety of useful services at the lowest possible costs, and therefore provide “good value.”

- (ii) *Establishing an efficient and consistent regulatory framework that applies to all participants and is founded on functional neutrality;*

Currently, many stakeholders believe that our regulatory framework does not adequately support competition, because the same rules of the road do not apply to everyone and those rules are often hard to determine. A more effective regulatory framework would provide more certainty and a more efficient level of intervention: too much regulation will stifle competition or engender needless costs, but not enough will result in the objectives of the National Payments Policy not being reached and in costs being inappropriately distributed among participants.

One of the problems with the current regulatory framework is that similar services offered by different providers may be subject to quite different rules. This situation engenders uncertainty and risk, and may put some providers at a needless disadvantage. Rules should address consistently similar services, whoever dispenses them.

- (iii) *Facilitating competition among a wide variety of providers and services, including through the elimination of unnecessary barriers; and*

- (iv) *Promoting interoperability, both at the national and international levels.*

Finally, payments are well known to raise specific problems that are attributable to “network effects”: payment mechanisms are successful insofar as many are willing to use them in order to pay and as many are also willing to accept payments through them. All other things being equal, a bigger network offers advantages and may be more efficient than many small ones. There is therefore a need to balance competition with efficiency. One solution is to promote interoperability and cooperation between competing networks.

The Canadian payments system must also be open to the world. Trade is increasingly global, online trans-border transactions are becoming common and Canadians travel abroad while citizens from other countries come to Canada. The payments system must be able to accommodate the challenges raised by the globalization of our financial activities.

## ***D – Interpreting the National Payments Policy***

A National Payments Policy such as the one being recommended cannot, and it is not intended to, answer all specific questions that may arise. Its aim is to provide guidance for decision-makers who will face a great range of challenges. Therefore, the Policy proposes broad principles, rather than very

detailed rules. When required, the latter may be derived from the objectives set by the Policy. Sometimes, this requires that the broader policy be interpreted, in order to determine how specific problems should be solved in a way that resonates with the Policy. In drafting the National Payments Policy, we have given heed to two concerns which should guide such interpretation.

The draft statement of the National Payments Policy is presented in a type of language that is commonly used in legislation. It assumes that the legal rules of interpretation that apply to legislation would be used in order to clarify its ambit if and when necessary. It also assumes the existence and application of other legislation, such as the *Competition Act* or the *Personal Information Protection and Electronic Documents Act*, and therefore does not delve in any detail into issues addressed by other statutes. It also assumes that courts and other decision-makers will interpret its provisions by seeking out the intent of the authors, rather than limiting themselves to a strictly literal interpretation of the Policy's provisions.

It is also a rule of legislative interpretation that courts and other bodies should look at a statute in a holistic manner: the meaning of any provision is influenced by the whole. In this context and while the objectives are proposed as being in a hierarchy, with trust being paramount, it is also crucial that they be understood as being interdependent in their interpretation and application.

## Notes

<sup>1</sup> The Minister of Finance must also be of the opinion that it is in the national interest to designate a clearing and settlement system.

<sup>2</sup> Sections 6 and 7 of the Act dealing with the making of regulations have not yet been brought into force. The provisions giving the Financial Consumer Agency of Canada supervisory powers with respect to compliance with the Act, including compliance agreements, are currently in force.

<sup>3</sup> Despite her best efforts, Sonia is unable to get a clear sense of the risks and protections associated with making purchases through various payment means and in different contexts, such as in-person or online. Critical information is virtually incomprehensible, hidden in the fine print, not available to consumers, or of questionable legal status.

<sup>4</sup> This regulation-making authority would include the power to define the payment service providers to whom the provisions of the legislation apply and to adjust that definition as necessary over time. It would also include the authority to impose user protection measures in relation to matters such as general disclosure requirements, error handling, limitations on liability in the event of fraud or unauthorized payments, notices regarding changes in terms, or protections required for preauthorized transfers.

<sup>5</sup> The *Bank Act* is an example of an institutional approach to regulation. Only specific entities—banks—are subject to the provisions of the *Bank Act* even though other entities perform some of the same functions as banks. In contrast, the *Payment Card Networks Act* applies to any entity that meets the definition of a payment card network operator and is considered a functional approach to regulation.

<sup>6</sup> The Task Force originally adopted the wording “transfer of *value*” to recognize that a payment can carry information in relation to the transaction that is not about the good or service but about the payment itself. “Value” was expanded to “*monetary value*” on recommendation of the Regulatory Advisory Group to make it clear that we are referring to the payment component of a transaction (not, for example, to the value of a good or service exchanged as part of a barter transaction).

<sup>7</sup> For instance, the European Commission has, through its Payment Service Directive (PSD), created three types of payment service providers: credit institutions, electronic money institutions and payments institutions. These entities have specific registration and authorization requirements and face legal restrictions. In addition, the PSD requires different capital requirements based on the type of activities performed by the payment service providers.

<sup>8</sup> As a result, two similar entities may be treated quite differently depending on the specific functions they perform. For example, an Internet service provider that relays messages between a user and its suppliers or between two payment service providers would not fall within the definition. An application that establishes a relationship with the user for providing a payments service, however, would fall within the definition. The same would hold for suppliers of communications devices: a firm that installs and maintains control of a payments application on its device would be considered a payment service provider, but the network through which that service is provided would not.

<sup>9</sup> Section 7 of the federal *Telecommunications Act* establishes the Canadian Telecommunications Policy based on the essential role that telecommunications performs in the maintenance of Canada’s identity and sovereignty and articulates seven more specific objectives, including affordability, privacy, efficiency and competitiveness. Section 3 of the *Broadcasting Act* lists some 20 specific objectives for a national broadcasting policy.

<sup>10</sup> *Federal Reserve Policy on Payment System Risk*

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<sup>11</sup> *Oversight Standards for Euro Retail Payment Systems*, European Central Bank, June 2003.

<sup>12</sup> Ibid.

<sup>13</sup> *U.K. Banking Act*, 2009

<sup>14</sup> Directive on settlement finality in payment and securities settlement systems

<sup>15</sup> *Payment Clearing and Settlement Act*

<sup>16</sup> Directive on Settlement Finality in Payment and Securities Settlement Systems

<sup>17</sup> Payment Services Directive

<sup>18</sup> National Bank of Belgium FSR 2007

<sup>19</sup> CPA LVTS Rule 3 – Access to LVTS states under section 3.7 – Technical Competency Systems

<sup>20</sup> Payment Service Directives

<sup>21</sup> Payment Services Directive

<sup>22</sup> Directive on Settlement Finality in Payment and Securities Settlement Systems