

Blakes

Retail Payment Activities
Act

Draft Regulations
Presentation to CPPO

March 6, 2023

Agenda

1. Retail Payment Activities Act and Draft Regulations - timeline
2. PSPs– the regulatory perimeter
3. Draft Regulations
4. Next Steps – legislative and regulatory processes

Retail Payment Activities Act (RPAA) - timeline

- RPAA received Parliamentary approval on June 29, 2021; not yet in force
- Regulations were required to support the RPAA – drafted by the Department of Finance Canada
- Concurrently, Bank of Canada (appointed regulator):
 - formed Retail Payments Advisory Committee (RPAC) to provide industry expertise to the Bank and consulted with industry stakeholders
 - developed a supervisory framework for PSPs (yet to be published)
- Draft Regulations were submitted to the Treasury Board for approval
- Published in Part I of the *Canada Gazette* on February 11, 2023
 - Forty-five days of public consultation (closing on March 28, 2023)

PSPs – the regulatory perimeter

- What does the RPAA regulate?
 - Retail payment activities that are either performed:
 - by a “payment service provider” (“PSP”) that has a place of business in Canada, or
 - for an “end user” in Canada by a PSP that does not have a place of business in Canada, but directs retail payment activities at individuals or entities that are in Canada.
- What is a PSP?
 - entity that performs a “payment function” as a service or business activity that is not incidental to another service or business activity
- Finally, what are “retail payment activities” and “payment functions”?

“Retail payment activity” and “payment function”

- Both terms are defined in the RPAA:
 - Retail payment activity means a *“payment function that is performed in relation to an electronic funds transfer that is made in Canadian currency or another country currency or using a unit that meets prescribed criteria”*
 - Payment functions consists of:
 - The **provision or maintenance of an account** that, in relation to an “electronic funds transfer,” is held on behalf of one or more end users;
 - The **holding of funds on behalf of an end user** until they are withdrawn by the end user or transferred to another individual or entity;
 - The **initiation** of an “electronic funds transfer” at the request of an end user;
 - The **authorization** of an “electronic funds transfer” or the **transmission, reception or facilitation of an instruction** in relation to an “electronic funds transfer;” or
 - The **provision of clearing or settlement** services.
 - (Electronic funds transfers are defined as *“a placement, transfer or withdrawal of funds by electronic means that is initiated by or on behalf of an individual or entity”*).

Out of scope – entities

- While the definitions of “PSP,” “retail payment activity” and “payment function” are all broad, there are some notable entities that are out of scope of the RPAA.
- These entities are either prudentially regulated financial institutions, crown corporations or regulated payment systems:
 - Banks and authorized foreign banks;
 - Credit unions;
 - A provincial government or an agent thereof if they accept deposits transferable by order;
 - Insurance companies;
 - Trust companies and loan companies;
 - Payments Canada;
 - The Bank of Canada;
 - Prescribed individuals or entities (of which there are none to date); and
 - Agents of registered PSPs.

Draft Regulations

- Much anticipated to provide clarity, not only on scope, application and regulated payment functions
 - RPAA also introduced the concepts of:
 - An operational risk management and incident response framework
 - Safeguarding of end-user funds
- While little clarity provided on the “regulatory perimeter” – much detail provided on risk management and funds safeguarding
- Regulations are quite prescriptive in respect of expectations on PSPs, irrespective of their size; that prescription comes with a significant compliance cost
- Will review key messages in the following slides.

Risk Management and Incident Response

- Some of the most onerous provisions of the draft Regulations
- Set out a comprehensive requirements for developing and operationalizing a risk management and incident response framework (Framework), including:
 - Framework must contain two expressly-stated objectives:
 - That a PSP can perform its payment activities without “reduction, deterioration or breakdown” and ensure the availability of its systems, data, and information to perform those activities; and
 - Preserving the integrity and confidentiality of a PSP’s payment activities, data and information
 - Setting out clearly defined and measurable SLAs
 - Identifying all assets and business processes to perform relevant payment activities
 - Identifying and describing all potential causes of operational risk
 - An obligation to carry out continuous monitoring
 - Appropriate oversight of third-party service providers and agents
 - A comprehensive response and recovery plan for any “incident” – *defined as an event or series of related events that is unplanned and that results in or could reasonably be expected to result in the reduction, deterioration or breakdown of any payment activity performed by a PSP*

Is the Framework risk based?

- Throughout the legislative process, Finance has stressed that the Framework (and other components of the RPAA) are to be considered or implemented in a manner that is proportionate to the risk introduced by a PSP or particular payment activity.
- The draft Regulations reference the concept of “ubiquity and connectedness” as well as a PSP’s relative size
- However, all the Framework requirements are mandatory, and are not scaled to account relative risk, size, payment function (with the exception of funds safeguarding, discussed below), ubiquity or connectedness
- What is the impact of this one-size-fits-all Framework?
 - On innovation?
 - On competition?

Framework – review and testing

- Framework must be reviewed once a year for compliance, and once every three years to test its effectiveness
- An independent review (either internally or by external auditor) must be completed at least every three years
- Records of the effectiveness testing must be maintained

- Overall impact: the Framework is both prescriptive and onerous. It will also require PSPs devote significant resources to managing and documenting compliance with the RPAA, regardless of the PSP's size

Fund Safeguarding

- Funds safeguarding was set out in the RPAA; draft Regulations add significant detail and set out the requirements for both a funds-safeguarding framework and a compliance program
- The RPAA requires that end-user funds are held in a segregated trust account, or segregated account back by insurance or guarantee. The draft Regulations add detailed requirements:
 - *Where* end-user funds can be maintained: with eligible FIs: Canadian banks, credit unions, trust or loan companies; similar foreign financial institutions
 - *How* funds are guaranteed: insurance or guarantee must be provided by an eligible Canadian or foreign FI
 - cannot be an affiliate of the PSP, but the same institution can hold the end-user funds account and provide the insurance or guarantee
 - Funds must be “bankruptcy remote”
 - Safeguarding-of-funds framework: must ensure end-users have reliable access without delay to funds
 - Require the use of a ledger system to keep a record of end-users and their funds
 - Insolvency administration framework
- Bank of Canada is expected to provide further clarity on safeguarding obligations

Provision of information

- In addition to the obligations discussed above, PSPs are required to submit detailed annual reports to the Bank of Canada
- The draft Regulations set out a large amount of prescribed additional information covering broad categories of PSP data, with more onerous obligations for PSPs with a place of business in Canada
- The reporting program leverages each of the compliance elements set out above and requires the PSP to provide the Bank of Canada with descriptions about how each requirement is implemented
- Annual report also requires extensive information in respect of the PSPs business in the preceding year, including:
 - The maximum value of end-user funds of all currencies held by the PSP at any time for all end-users and for end-users in Canada
 - The daily average value of the end-user funds of all currencies held each month
 - The volume and value of electronic funds transfers performed for end-users in Canada

Record keeping, retention and AMPs

- Record keeping and retention is also detailed in the Regulations
 - PSPs must maintain sufficient records, in a form intelligible to the Bank of Canada, to demonstrate its compliance with the RPAA
 - Must take reasonable measures to secure them

With respect to Administrative Monetary Penalties:

- Similar to the administrative monetary penalty regulations under the PCMLTFA, classifications of violations are either “serious” or “very serious.”
- Among the very serious violations are those relating to a PSP’s obligations to implement and maintain the Framework, including a failure to carry out the required review, effectiveness testing and independent testing required within the periods prescribed, and a failure to appropriately safeguard end-user funds.

Next steps

- Public comments are accepted until March 28, 2023
- The Government will review comments and consider changes to the Regulations (if required)
- A final version of the Regulations will be Published in Part II of the Canada Gazette
 - The Bank of Canada plans to issue supervisory guidance once the regulations are published, which will:
 - Explain the Bank's interpretation of the RPAA
 - Provide transparency around their role
- The Regulations will likely come into effect in stages, when relevant provisions of the RPAA come into force
 - National security and compliance provisions would come into force when the RPAA provisions requiring PSPs to submit a registration application come into force, for example.

Q&A Session

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