

Executive Summary: ETA Comment Letters on Canadian Payments Issues

Comments on The Department of Finance Canada's, "A New Retail Payments Oversight Framework: A Consultation Paper"

Framework Summary:

The retail payments space is generally not regulated in Canada except in limited circumstances and in any event, not from a safety and soundness perspective. This is because under the current regulatory framework, focus is placed on the type of entity performing the payment activity and provided that the entity is not taking deposits, not on the actual activity being performed; in other words "who you are, and not what you do". As such, non-traditional payment service providers, including fintechs (collectively, PSPs), have not previously been subject to regulatory oversight. The proposals set out in the Consultation Paper break new ground in respect of the regulation of retail payments in Canada and propose a complete regulatory regime for PSPs.

Measures proposed:

- **Registration:** A registration requirement for PSPs is proposed. For existing PSPs (except those entities that only support the delivery of payment functions as suppliers for another PSP) registration will be required when the oversight framework comes into force. For new PSPs, registration will be required before any payment services are launched.
- **End-user safeguarding:** It is proposed that PSPs will be required to place end-user funds held overnight or longer into a trust account with a Canadian financial institution.
- **Operational standards:** Covered entities will be required to comply with security and operational objectives as well as with business continuity planning objectives to address operational risks. As part of the operational standards requirement, PSPs would be subject to operational system testing to ensure an appropriate level of data protection. Such testing is contemplated to be conducted through a self-assessment in the case of smaller firms, or through third-party verification, in the case of larger firms.
- **Dispute resolution:** The proposed regulatory regime provides for a mandatory dispute resolution process. As such, PSPs are required to have internal complaint handling processes and a designated external complaint body responsible for receiving complaints that fail to be resolved through the internal complaint handling processes.
- **Liability:** The regulatory regime contemplates that payors would not be held liable for losses due to unauthorized transactions or errors unless they acted fraudulently or failed to fulfil certain obligations.
- **Disclosures:** PSPs that have a direct PSP/end-user relationship will be required to provide end-users with mandated disclosures presented in a clear and simple manner on the service or product being obtained, as well on the customer's and PSP's responsibilities.

ETA's recommendations:

- **Registration:** ETA suggests that the registration requirement include an exception for entities that are already registered with the payment card networks. The proposed additional layer of

administration is not necessary and would be burdensome and costly for those PSPs that would face multiple registration requirements. If the Department implements a registration requirement, the process should incorporate due process protections for PSPs. Any company denied a registration, or that has one revoked or suspended, should have due process rights to challenge the adverse action and stay in business until a final determination (after a right of appeal).

- **End-user fund safeguarding:** The Department has proposed to require PSPs to hold customer funds in a government-insured, trust account that meets certain specific requirements, including that the funds be held in cash or highly secure financial assets. ETA encourages the Department to consider an alternative approach – requiring Canada Deposit Insurance Corporation (“CDIC”) pass-through insurance to customer funds held in FBO (for the benefit of) accounts. If the Department moves forward with its current proposal, the Department should consider implementing a materiality threshold, below which funds would not need to be held in trust accounts
- **Operational standards:** The Department should take into account the various industry self-regulatory efforts that have established widely-adopted operational standards for the payments industry. In Canada, the credit and debit card networks and their participants have adopted a Code of Conduct for the Credit and Debit Card Industry in Canada that establishes numerous operational and compliance standards for the industry. The Department’s paper does not explain why entities that are already subject to regulation should be subjected to additional requirements or identify any specific market failures or consumers harms that would be addressed by doing so.
- **Dispute resolution:** ETA and its members support customer service and dispute resolution but suggest that this may be an area where industry self-regulation is a better solution. If the Department moves forward with the proposed requirement, PSPs should have the flexibility to implement programs built around the unique circumstances of each PSP.
- **Liability:** ETA supports processes and procedures that protect consumers from theft and fraud. ETA also generally supports the Department’s proposal that a payor would not be liable for unauthorized transactions, except under certain circumstances, including, for example, where the payor did not take reasonable care to protect the security of its password. ETA suggests that the Department expand the number of exceptions in which the payor would be responsible to also include instances of fraud by the payor. In addition, a PSP should not be liable for accounts that are not registered or verified at the time the error is reported.
- **Disclosures:** The Department should avoid overly-prescriptive disclosure requirements that may interfere with the ability of PSPs to provide convenient and innovative products and services. The Department should take a more flexible, principles-based approach that allows PSPs to implement disclosures that are tailored for their specific products and services.

Comments on Payment's Canada Modernization Target State Document

Document Summary: This document outlines Payments Canada's vision for modernization and specifically the introduction of a Real-Time Rail ("RTR") to serve as a platform for innovation in the Canadian payments ecosystem.

Payments Canada will introduce a real-time payment capability in the form of a Real-Time Rail, which will serve as a platform for innovation in the Canadian ecosystem. As the operator of the system, Payments Canada will ensure the system satisfies the criteria for determine access criteria, set the legal and rules framework, determine pricing to participants and set the future development roadmap of the system.

ETA's recommendations:

- **System access:** ETA and its members understand the importance of establishing eligibility requirements for obtaining access to the payments systems. In that regard, in framing the eligibility criteria, ETA and its members caution that if the ability to participate in RTR is too restrictive or overly cumbersome, this will have a negative impact on competition. As such, ETA and its members believe that in establishing eligibility criteria for the RTR system, Payments Canada should consider a risk-based approach that leverages off the new Retail Payments Oversight Framework that is concurrently being developed by the by the Department of Finance to avoid duplicative sets of regulation to address similar risks. In formulating the access rules, ETA also believes Payments Canada should tailor the approach so that it is appropriate for the FinTech industry's participation.
- **Encourage competition:** ETA and its members support an inclusive financial system that provides high quality, secure and affordable financial service for the broadest set of consumers and businesses. In that regard, ETA fully supports a modernized payment system that will result in increased competition and financial inclusion while also ensuring safety and soundness. In order to maintain a competitive marketplace, it is important that Payments Canada, as part of its modernization effort, take into account the costs of participation that may be imposed on FinTech participants for using the RTR platform, whether directly or indirectly, so that all participants are on a level playing field. In that regard, it is important that costs (both direct and indirect) for a FinTech's access to the RTR platform not be structured in a manner that will pose a strategic disadvantage to FinTech participants
- **Safety and soundness:** ETA and its members understand that for the RTR platform to function properly and have broad adoption, safety and security protocols are critical. As such, ETA and its members agree that there should be established rules and standards that will incorporate a baseline set of requirements to enable payments to move securely where end users have trust and confidence in the system. In keeping with the regulation of Prominent Payment Systems, ETA and its members support a system that addresses legal, credit, liquidity, operational and other risks across the system. ETA and its members encourage Payments Canada to work with banks and/or other institutions with direct access to the RTR platform to ensure the adoption of a collaborative approach which allows for the sharing of information to enhance cyber security

threat protections and support payment system resiliency while at the same time enabling FinTech's to seamlessly adopt to the required protocols

- **Efficiency:** ETA supports a positive regulatory environment for innovation, in line with the principles espoused by both the Competition Bureau (in its report of *Technology led innovation and emerging services in the Canadian financial services sector*) and Payments Canada (in its *Modernization Target State* report). In respect to regulations, ETA believes that any regulations drafted for participation in the RTR platform (whether direct or indirect) should leverage off existing legal frameworks, to avoid duplicative regulatory burdens that result in inefficiencies and higher costs for end users of FinTech services, depriving end users from obtaining the benefits of the advanced technology that the FinTech industry has to offer.
- **Transparency:** ETA and its members strongly encourage an open and transparent bidding process and more open access for service providers as Payments Canada moves to select the RTR vendor.

Comments on Competition Bureau Canada's draft report on technology-led innovation and emerging services in the Canadian financial services sector

Draft report summary:

This study addresses five over-arching questions:

1. What has been the impact of FinTech innovation on the competitive landscape for financial services?
2. What are the barriers to entry, expansion or adoption of FinTech in Canada?
3. Are the barriers regulatory or non-regulatory?
4. Are changes required to encourage greater competition and innovation in the sector?
5. What issues should be considered when developing or amending regulations to ensure competition is not unnecessarily restricted?

To ensure relevance for Canadians, this study focuses on innovations that affect the way Canadian consumers and SMEs commonly encounter financial products and services, with focus on three broad service categories:

- Payments and payment systems: This includes retail payment products and services (e.g. mobile wallets), as well as the infrastructure that supports these products and services (e.g. the clearing and settlement system).
- Lending: This includes consumer and SME lending (e.g. peer-to-peer or marketplace lending) and equity crowdfunding.
- Investment dealing and advice: This includes do-it-yourself investing and portfolio management through online platforms (e.g. "robo-advisors").

ETA's recommendations:

- ETA urges policymakers to remain thoughtful and forward-thinking in how to best support industry's on-going efforts to provide opportunities for all consumers and small businesses to access and benefit from innovative financial products and services without unnecessarily disrupting or burdening well-worn, efficient/reliably servicer models. Efforts by policymakers to regulate financial products and services should be done collaboratively with industry participants and with careful consideration.
- Regulation should be technology-neutral and device-agnostic. Prescriptive rules regarding how a firm must comply with a regulation are often written with the technology of the day in mind.
- To the extent possible, regulation should be principles-based. Policymakers should aim to create regulation based on expected outcomes rather than on strict rules of how to achieve those outcomes. Principles-based regulation has the added benefit of allowing regulators the flexibility to issue guidance and be more flexible in their approach to enforcement as technology changes.
- Regulation should be based on the function an entity carries out. Current regulations at the federal level apply only to certain entities defined within legislation. There are varying levels of

regulation for the same activity or function performed by different entities. This contributes to the potential imbalance created as entities have different standards to which they must adhere.

- Regulators and policymakers should ensure regulation is proportional to the risks that the regulation aims to mitigate. Together with function-based, principles-based and technology-neutral regulations, proportional regulation ensures that FinTech entrants will compete on a level playing field. At the same time, it will reduce the risk of regulatory arbitrage.
- Regulators should continue their efforts to harmonize regulation. Regulators and policymakers should make best efforts to harmonize regulation across geographic boundaries.
- Policymakers should encourage collaboration throughout the sector. More collaboration among regulators at all levels would enable a clear and unified approach to risk, innovation and competition. Greater collaboration between the public and private sector more broadly would foster greater understanding among regulators of the latest services—and of the regulatory framework among FinTech firms.
- Policymakers should identify a clear and unified FinTech policy lead for Canada with federal, provincial and territorial expertise to facilitate FinTech development.
- Regulators should promote greater access to core infrastructure and services to facilitate the development of innovative FinTech services under the appropriate risk-management framework. Access to core infrastructure, such as the payments system, would enable more market participants to deliver new overlay services to payments customers (e.g. bill payment applications, international remittances, foreign exchange services).
- Policymakers should embrace broader "open" access to systems and data through application programming interfaces. With more open access to consumers' data (obtained through informed consent and under an appropriate risk-management framework), FinTech can help consumers overcome their inability or unwillingness to shop around by paving the way for the development of bespoke price-comparison tools, and other applications that facilitate competitive switching.
- Industry participants and regulators should explore the potential of digital identification to facilitate client identification processes. Digital identification could help reduce the cost of customer acquisition for new entrants and incumbent service providers alike, while reducing the costs of switching for consumers and facilitating regulatory compliance where identity verification is needed.