Guideline Related to Bank of Canada Oversight Activities under the Payment Clearing and Settlement Act

This Guideline, which is subject to periodic revisions at the Bank's discretion, was last updated in April 2018.

Introduction

Under the Payment Clearing and Settlement Act (PCSA), which became law on 31 July 1996, the Bank of Canada is responsible for the regulatory oversight of clearing and settlement systems (also known as financial market infrastructures or FMIs) with a view to controlling systemic risk and payments system risk in Canada.

Financial market infrastructures (FMIs) are the channel through which virtually all financial transactions are cleared, settled and recorded. Firms providing financial services access these FMIs to perform , they allow consumers and firms to safely and efficiently purchase goods and services, make financial investments, and transfer funds. FMIs can therefore play an important role in enhancing financial stability.

However, FMIs themselves can pose certain risks or be a major channel through which these risks can be transmitted. Some FMIs (referred to as "prominent payments systems") pose payments system risk. This risk can arise when payment services provided by the FMI are disrupted, leading to adverse effects on Canadian economic activity. There are other FMIs (referred to as "systemically important FMIs") that pose systemic risk. At these FMIs, the inability of one participant to meet its obligations to the FMI could, by transmitting financial problems through the FMI, cause other participants to be unable to meet their obligations.

It is therefore essential that FMIs incorporate appropriate risk-control mechanisms so that systemic risk and payments system risk are adequately controlled.

The objectives of the Bank in its oversight role, as described in the Preamble to the PCSA, are to ensure that systemically important FMIs and designated prominent payment systems operate in such a manner that risk is properly controlled and to promote efficiency and stability in the Canadian financial system.

Purpose of the Guideline

The purpose of this Guideline is to describe the Bank's oversight framework and practices.[1] Specifically, it will describe:

[1] The PCSA allows for the Bank to issue guidelines in respect of its administration or enforcement of the Act.

Key Terms Used in the Guideline

Financial market infrastructure (FMI): A system that facilitates the clearing, settling or recording of payments, securities, derivatives or other financial transactions among participating entities.[2] The three types of FMIs overseen by the Bank are:

- **payment systems (PSs)**, which facilitate the transfer of funds;
- **central counterparties (CCPs)**, which become the buyer to every seller and the seller to every buyer of a financial contract to ensure that, even if a buyer or a seller fails to meet its obligation to the CCP, obligations will be met on all contracts; and
- **securities settlement systems (SSSs)**, which facilitate the transfer of securities and other financial assets. SSSs often operate in conjunction with central securities depositories (CSDs), which provide securities accounts, central safekeeping and asset services. SSSs may provide additional securities-clearing and settlement services, such as CCP clearing services.

Designated FMI: An FMI that is subject to Bank of Canada oversight. FMIs can be designated as systemically important to the Canadian financial system or as prominent payment systems.

Systemic risk: As defined by the Payment Clearing and Settlement Act, systemic risk is the risk that the inability of a participant to meet its obligations as they become due or a disruption to or a failure of an FMI could, by transmitting financial problems through the FMI, cause

(i) other participants to be unable to meet their obligations as they become due;
(ii) financial institutions in other parts of the Canadian financial system to be unable to meet their obligations as they become due; or
(iii) the FMI or another FMI in the Canadian financial system to be unable to meet their obligations as they become due.
(iv) an adverse effect on the stability or integrity of the Canadian financial system. [3]

Systemically important FMI: An FMI that has the potential to be operated in a manner that could pose systemic risk.

Payments system risk: As defined by the Payment Clearing and Settlement Act, payments system risk is the risk that a disruption to or a failure of a clearing and settlement system could cause a significant adverse effect on economic activity in Canada by

i. impairing the ability of individuals, businesses or government entities to make payments, or
ii. producing a general loss of confidence in the overall Canadian payments system, which includes payment instruments, infrastructure, organizations, market arrangements and legal frameworks that allow for the transfer of monetary value.

Prominent payment system: A payment system that has the potential to be operated in a manner that could pose payments system risk.

[2] An FMI is defined as a multilateral system, including its participants, and not simply as the legal or functional entity that performs the clearing, settlement or recording function.
[3] In a more general sense, systemic risk can also be defined as the probability that the financial system will not function as needed to support economic activity.

1. The Payment Clearing and Settlement Act

The Payment Clearing and Settlement Act (PCSA), which became law in 1996, provides the Bank with the legislative authority and powers to oversee clearing and settlement systems (also called financial market infrastructures or FMIs) that may be operated in such a manner as to pose systemic risk or payments system risk. The PCSA is the federal government's recognition of the essential role of the major FMIs in the Canadian economy, and of the importance of regulatory oversight of these FMIs. The PCSA provides the Bank with two main oversight responsibilities: (i) designating FMIs that have the potential to pose systemic risk or payments system risk as subject to Bank oversight; and (ii) overseeing designated FMIs to ensure they are adequately controlling systemic risk or payments system risk. The PCSA provides the Bank with a number of powers to support these two responsibilities. The Act

- allows the Bank to collect information from FMIs to determine their eligibility for oversight and to determine whether they have the potential to pose systemic risk or payments system risk as defined in the PCSA;
- empowers the Governor to designate an eligible FMI as being subject to Bank oversight when he or she is of the opinion that the FMI may be operated in such a manner as to pose systemic risk or payments system risk, and the Minister of Finance is of the opinion that it is in the public interest to designate it;
- allows the Bank to enter into an agreement with a designated FMI with respect to its oversight arrangements or other matters that pertain to the FMI's control of systemic risk or payments system risk;
- empowers the Bank to conduct audits of a designated FMI;
- requires that all information obtained by the Bank from an FMI under the PCSA be treated as confidential, while still allowing the Bank to share such information with the FMI's other regulatory authorities as it relates to the regulatory activities of those institutions in relation to the FMI;
- empowers the Governor to issue a written directive to a designated FMI to refrain from an action that is likely to result in systemic risk or payments system risk being inadequately controlled or to take action to remedy a situation in which systemic risk or payments system risk is likely being inadequately controlled;[4]
- empowers the Governor to apply to a superior court to obtain an order directing an FMI to comply with the PCSA, a directive or a legal agreement entered into with the Bank under the PCSA; and
- requires designated FMIs to provide the Bank with reasonable notice in advance of any change to be made that is of a significant nature in relation to the designated FMI, which enables the Bank to consider the implications of such changes for systemic risk or payments system risk.

In addition to providing the framework for the Bank's oversight, the PCSA contains a number of other provisions that do not relate directly to the Bank's conduct of oversight, but that support the Bank's objective of ensuring that systemic risk and payments system risk are adequately controlled in Canada. These provisions

- in conjunction with federal insolvency legislation, bolster the legal enforceability of netting in designated FMIs;

[4] In order to issue a directive to an FMI that is established by or under a statute, the Governor requires the approval of the Minister of Finance.

- render the settlement rules of designated FMIs immune to legal stays or other legal challenges, even in cases in which a participant in one of these systems fails. This increases the certainty that the legal arrangements governing the operations of a designated clearing and settlement system will produce the expected outcome in periods of financial stress;
- empower the Bank to provide a guarantee of settlement to designated FMIs;
- empower the Bank to make liquidity loans to designated FMIs; and
- empower the Bank to accept and pay interest on deposits from the FMIs and their participants.

While the PCSA provides the foundation for federal oversight and control of systemic risk and payments system risk in FMIs, the Bank developed this guideline to provide further clarity on how it fulfills its two main oversight responsibilities.

2. The Designation Process

2.1 Identification of Eligible FMIs

The PCSA clearly states that the Bank's oversight responsibilities apply to clearing and settlement systems that have the potential to pose systemic risk to the Canadian financial system or payments system risk to Canadian economic activity. It is not necessary for an FMI to be located in Canada to be eligible for designation. To be eligible, an FMI needs to meet the definition of a clearing and settlement system in the PCSA, which is limited to systems or arrangements for the clearing or settlement of payment obligations (or payment messages) and other financial transactions such as securities, derivatives or foreign exchange transactions. A clearing and settlement system is eligible for designation if:

- it has three or more participants, at least one of which is Canadian,[5] and at least one of which is headquartered in a different Canadian province or a different country than the FMI's head office;
- it clears or settles transactions all or partly in Canadian dollars; and
- except in the case of a system or arrangement for the clearing or settlement of derivatives contracts, the payment obligations arising in the FMI are ultimately settled through adjustments to accounts of one or more participants at the Bank of Canada.

Because FMIs that meet these criteria are eligible for designation, they are referred to as "eligible FMIs" in this Guideline.

2.2 Designation of Eligible FMIs That May Pose Systemic Risk

Under the PCSA, the Governor may designate an eligible FMI for Bank oversight when he or she is of the opinion that it may be operated in such a manner as to pose systemic risk. For designation to take effect, the Minister of Finance must be of the opinion that designation is in the public interest.

The Bank regularly monitors the financial landscape and conducts analysis to identify FMIs that meet the eligibility criteria and may have the potential to pose systemic risk to the Canadian financial system.

[5] A Canadian participant is defined as a participant that is incorporated or formed under an enactment of Canada or a Canadian province.

Three key factors that the Bank considers when making its assessment of systemic risk are: (i) the size of the transactions cleared or settled by the FMI; (ii) the degree to which the FMI plays a critical role in supporting Canadian financial markets and the Canadian economy; and (iii) the size of obligations that Canadian participants can incur through participation in the FMI.

(i) **The size of transactions cleared or settled by the FMI:** An FMI that clears or settles large-value transactions is likely to be important to the participants and markets it serves.

(ii) **The degree to which the FMI plays a critical role in supporting Canadian financial markets and the Canadian economy:** An FMI might be considered critical to the Canadian economy or financial markets if there are few or no substitutes for the service(s) it performs, if it has important links to other major FMIs that support the Canadian economy and financial markets, or if it supports Canada's critical markets. For instance, a payment system that settles payment obligations arising from other FMIs, or one that supports critical functions such as the Bank's execution of monetary policy, is critical to the proper functioning of Canadian markets and the broader economy. A disruption to a critical FMI's services would affect the participants and markets that rely on it, potentially causing detrimental effects that could spread through these participants and markets to the broader economy. Therefore, the importance of an FMI to the Canadian financial system and to the economy as a whole is a key indicator of its potential to pose systemic risk through the transmission of risk beyond the FMI and its participants.

(iii) **The size of obligations that Canadian participants can incur through participation in the FMI:** If large-payment or securities obligations arise in an FMI, participants (or the FMI itself) may have difficulty meeting their obligations in the event that one (or more) other participants do not meet their obligations when they are due. For instance, if *Participant A* cannot make its payments to *Participant B* and *Participant C* in a payment system, *B* and *C* may then be unable to make their own payments, since they may rely on their incoming payments from *A* to fund their outgoing payments. These effects could potentially spread across participants in the FMI, or even spread to other FMIs and markets. The size of the obligations that each participant could incur in an FMI relative to its available financial resources is therefore an important indicator of the FMI's potential to pose systemic risk through the transmission of risk among participants in the FMI.

The Bank may consider other characteristics when conducting its assessment of systemic risk. Different types of FMIs (and the markets they serve) have different characteristics and face different kinds of risk, so it is necessary that the Bank take an FMI's unique traits into consideration.

If the Governor concludes that an eligible FMI is unlikely to pose systemic risk, it will not be designated. However, the Bank will continue to monitor the FMI to determine whether any conditions have changed that would warrant a reconsideration of this decision.

If the Governor concludes that an eligible FMI may be operated in such a manner as to pose systemic risk, and the Minister of Finance is of the opinion that designation is in the public interest, the Governor will designate the system for oversight. The Governor then notifies the FMI about its designation in writing. When the designation takes effect, the FMI will be subject to regulatory oversight by the Bank under the PCSA and will be expected to comply with Section 3 of this Guideline, which discusses the Bank's oversight of designated FMIs. A copy of the designation notice that was provided by the

Governor to the FMI will also be published in the *Canada Gazette* to inform the public of the designation.

2.3 Designation of Eligible Payment Systems That Could Pose Payments System Risk

Under the PCSA the Governor may designate an eligible FMI for Bank oversight when he or she is of the opinion that it could be operated in a manner that poses payments system risk. For designation to take effect, the Minister of Finance must be of the opinion that designation is in the public interest.

The Bank of Canada has established five high-level criteria to help identify prominent payment systems (PPS):

(i) **Value and volume of transactions:** Value and volume are a proxy for the potential to pose credit, liquidity and operational risk. They reflect the magnitude and potential impact should risks materialize. The larger the value and volume of the transactions processed, the more significant the potential impact on the Canadian economy and financial system in the event of a disruption.

(ii) **Availability of substitutes:** If a system has limited substitutes, even imperfect substitutes, it is more likely that adverse economic effects, or a generalized loss of confidence, will result in the event of a disruption to that system. The fewer substitutes there are for making payments, the larger the potential impact of a disruption because direct participants and end-users have limited alternatives to effect payments.

(iii) **Time criticality of payments:** The more time-critical payments are, the larger the potential impact if there is a system disruption. Further, the more time-critical payments a given system clears and settles, the more likely the disruption will result in adverse economic effects. If end-users experience delays in the clearing and settlement of their time-critical payments, they may be more likely to lose confidence in the overall Canadian payments system.

(iv) **Centrality:** This refers to both a system's importance in the payments system and its importance to the market it serves. In this regard, centrality is accentuated when multiple stakeholders and payment instruments depend on one platform, with no alternative providers. A central system has a greater potential to have an impact on economic activity because a greater number of payments instruments and end-users could be affected. Similarly, the scope of the impact on confidence is also broadened.

(v) **Interdependencies:** A payment system that is dependent on other systems has a greater capacity to affect or be affected by those systems on which it is dependent in the event of a disruption. This interdependency has the potential to increase the economic effects of a disruption and broaden the impact on confidence in payment systems.

If the Governor concludes that an FMI is eligible for designation, the Governor will then notify the FMI about its designation in writing. When the designation takes effect, the FMI will be subject to regulatory oversight by the Bank under the PCSA and will be expected to comply with Section 3 of this Guideline, which discusses the Bank's oversight of designated FMIs. A copy of the designation notice that was provided by the Governor to the FMI will also be published in the *Canada Gazette* to inform the public of the designation.

3. Oversight of Designated FMIs

3.1 The Bank's Oversight Objectives

An efficient and stable financial system is critical to the long-run stability and growth of the Canadian economy. The Bank's primary oversight objective is to be satisfied that systemic risk and payments system risk are adequately controlled in designated FMIs. Risk control is important to ensure that risks are contained and do not spread through the financial system. The Bank's secondary oversight objective is efficiency. Efficiency is important because an FMI that is not practical or cost-effective for its users may lead them to resort to less-costly arrangements that may pose increased risks. The Bank carefully considers the trade-off between risk control and efficiency in the conduct of its oversight responsibilities. Nonetheless, efficiency considerations do not take precedence over prudent risk management.

Under the guidance and oversight of the Bank, FMIs and their participants are responsible for operating their systems in a safe, sound and efficient manner and for determining how they will meet the applicable standards set by the Bank. While the FMI itself is ultimately responsible for managing its risks, the Bank, as overseer, is responsible for conducting consistent and effective oversight of FMIs and validating the adequacy of their risk-management practices.

The Bank exercises its oversight in a manner that is consistent with the responsibilities for authorities contained within the Principles for FMIs, which require that authorities have the appropriate powers and resources to oversee FMIs, that they clearly disclose their oversight policies, that they apply the Principles for Financial Market Infrastructures to applicable FMIs, and that they co-operate with each other to promote the safety and efficiency of FMIs.[6] The Bank endeavours to carry out its oversight responsibilities in a co-operative manner, and regularly holds meeting with FMIs and other regulatory bodies to achieve that objective. Consistent with the responsibilities for authorities, the Bank cooperates with other domestic and international authorities that also have responsibility for oversight and regulation of FMIs overseen by the Bank.

It is important that the Bank's oversight policies are clear and well-articulated. To promote transparency to FMIs, their participants and the public, the Bank publishes information and research pertaining to FMIs on its website. The Bank also publishes an annual oversight report on its website to provide transparency and accountability for the Bank's oversight views and activities. The report summarizes the Bank's main views with respect to oversight and designated FMIs. The report includes information about the Bank's activities and key developments over the course of the year in respect of each designated FMI and other financial market infrastructures, as well as Canadian and international initiatives relevant to Bank oversight.

3.2 Responsibilities of Designated FMIs

All FMIs and their participants are responsible for understanding and managing the risks to which they are exposed. FMIs need to have the capacity to proactively anticipate and identify risks incurred through their system and determine how those risks should be managed. The Bank expects designated FMIs to have an organizational culture and practices that are commensurate with their role as prominent payment system or as systemically important FMIs. Therefore, designated FMIs need to be aware of their role in the financial system and the Canadian economy and the implications this has for their

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[6] The Principles for FMIs are discussed in more detail under "Responsibilities of Designated FMIs" in the next section.

management of risks. They need to place a high priority on risk management at all levels of their organizations.

Designated FMIs are required to adequately manage systemic risk or payments system risk in their systems and are responsible for taking the actions necessary to address any shortcomings identified in their risk management. Designated FMIs must meet a number of responsibilities to satisfy the Bank that they are adequately managing systemic risk for systemically important FMIs, and payments system risk for prominent payment systems. In particular, FMIs are required to maintain appropriate risk-management practices and to provide the Bank with all the information necessary for it to assess whether the FMI is operating in a safe and efficient manner. The Bank may enter into a legal agreement with designated FMIs to formalize and clearly articulate its expectations regarding the Bank's oversight activities and the FMI's responsibilities to the Bank.

(i) Observe applicable risk-management standards

The Bank requires that all FMIs designated as systemically important observe the Bank of Canada risk-management standards and associated guidance. These standards fully incorporate the Principles and Key Considerations articulated in the Principles for Financial Market Infrastructures (PFMIs), which are international standards related to the risk management, efficiency and transparency of systemically important FMIs developed jointly by the Committee on Payment and Settlement Systems (CPSS)[7] and the Technical Committee of the International Organization of Securities Commissions (IOSCO). The PFMIs also contain explanatory notes that describe how an FMI may implement particular aspects of the standards. The risk-management standards for systemically important FMIs can be found here. The designated systemic FMI were expected to broadly observe all the principles by 31 December 2016.

The Bank has also developed risk-management standards for prominent payment systems. These standards are also based on the PFMIs; however, they are adapted to be proportionate to the nature and magnitude of payments system risk. As a result, the standards for prominent payment systems are less stringent in some areas than those in the PFMI. The risk-management standards for prominent payment systems can be found here.

(ii) Provide the Bank with information as requested

FMIs are required to provide the Bank with any information that it may reasonably request in writing. The Bank may set out expectations for certain information to be provided on a routine basis, but may also request information on an ad hoc basis. Routine information may include reports on the performance of the FMI's risk controls, such as stress-test results and reports on the management of operational incidents. Routine information could also consist of system data used by the Bank to conduct analysis and research.

(iii) Advance notice of significant changes

Designated FMIs are required to provide the Bank with reasonable advance notice of any significant changes to operations, arrangements, rules, procedures or other documentation in relation to the FMI. When submitting a proposed change, at a minimum, the FMI is expected to provide a motivation for the change; a description of the change; and an assessment of the risk implications of the change.

[7] In 2014, the CPSS was renamed as the Committee on Payments and Market Infrastructures (CPMI).

(iv) Bank may impose fees
The Bank of Canada may impose an annual fee on designated FMIs to cover the administrative costs of services provided under the PCSA. In the event that the Bank imposes a fee, an explanation of the basis for the calculation of this fee will be provided to the FMI.

3.3 The Bank's Main Oversight Activities
The Bank's main oversight activities relate to monitoring and evaluating risk in designated FMIs to satisfy itself that systemic risk and payments system risk are being adequately controlled in an efficient manner. The Bank does this by conducting assessments of designated FMIs against the corresponding set of Bank of Canada risk-management standards and requiring FMIs to undergo periodic audits and inspections. The Bank also regularly monitors FMIs and engages with their management. These are the processes generally followed by the Bank in its oversight of the domestic FMIs it has designated. However, not all of these monitoring activities are expected to be applied to foreign-domiciled FMIs, where the Bank conducts its oversight predominantly through co-operative oversight arrangements with the FMI's other regulators.

(i) Application of international and national risk-control standards
The Bank requires that all designated FMIs observe its risk-control standards. These standards are the CPSS-IOSCO Principles for FMIs for systemically important FMIs and the Bank of Canada risk-management standards for prominent payment systems. The Bank conducts regular assessments of FMIs' observance with these standards. Full assessments are done (i) when an FMI is first designated; (ii) when new standards are implemented; and (iii) on a periodic basis to ensure that FMIs continue to meet the standards. In addition, as part of its process to review all significant changes to FMI rules, procedures and operations, the Bank considers whether proposed changes are consistent with the relevant principles and standards. FMIs are also required to complete periodic self-assessments against the PFMIs and the Bank of Canada's risk-management standards.

(ii) Periodic audits and inspections
To carry out its responsibilities under the PCSA, the Bank (or a third party on the Bank's behalf) may conduct audits and inspections of a designated FMI.

At a minimum, the Bank requires that an external independent audit of the controls in place at each designated FMI be conducted annually. As part of this audit, the FMI's management provides the auditor with written descriptions of the designated system, its control objectives and the related controls it has in place. An independent examination is performed to obtain assurance of the existence of the documented controls, the suitability of the controls and their operational effectiveness during a specific period. The Bank approves the scope and control objectives of the audit.

The annual audit of internal controls is an important tool in verifying the effectiveness of the control environment for each designated system.

(iii) Priority setting
The Bank sets priorities for each designated FMI in consultation with the FMI and its other regulators and sets priorities for its own oversight work. Some priorities will be concrete actions aiming to improve the FMI's risk-management practices, while others will involve further analysis to improve the Bank's assessment of a particular risk. The Bank's oversight efforts will focus on areas where the Bank judges there is material risk (i.e., those with high severity or high likelihood of occurring) and where a better understanding of particular aspects of the FMI's risk-management process is required.

(iv) Regular monitoring and engagement

The Bank regularly engages with and reviews information provided by designated FMIs in order to monitor whether they are maintaining appropriate risk-control standards and to determine when corrective actions are necessary. For example, the Bank may require designated FMIs to provide reports detailing the performance of their risk-control measures against stated targets and describe the nature and resolution of operational events. The Bank then reviews and discusses these reports with designated FMIs. In addition, the Bank engages in dialogue with FMIs through the following mechanisms.

- The Bank's deputy governor primarily responsible for oversight meets periodically with the board of each designated FMI to ensure that the board understands the Bank's expectations and priorities, as well as any concerns the Bank may have regarding the FMI's operations or practices.
- The Bank has periodic formal meetings with the senior management of a designated FMI to discuss the FMI's operations, important past and future developments, and areas where the Bank requires the FMI to take certain actions.
- The Bank regularly engages with FMIs to discuss developments and ongoing issues and provide oversight perspectives.

If the Bank considers it necessary, it may request additional meetings between the FMI and the Bank's staff, management or deputy governor to discuss any concerns regarding systemic risk or payments system risk.

Finally, the Bank closely monitors any changes proposed by FMIs, including the development of new products and services and modifications to the FMIs' rules, procedures and operations. The Bank conducts reviews of proposed changes to determine whether those changes would be acceptable from the perspective of systemic risk or payments system risk.

3.4 Oversight of Foreign-Domiciled FMIs

Where the Governor designates a foreign-domiciled FMI, the focus of the Bank's oversight activities will be on the Canadian aspects of the FMI's operations (particularly the arrangements for clearing and settling Canadian-dollar payment obligations). The Bank expects to work closely with the central bank (and other regulators) in the country where the FMI is located, using formal co-operative oversight arrangements rather than independently overseeing the designated FMI.

To support the control of systemic risk to Canada that could originate in foreign-domiciled FMIs, the PCSA provides that Canadian participants in foreign-domiciled FMIs shall comply with the obligations that the Act imposes on the FMI and shall have all the rights that the Act confers on FMIs. For example, participants will obtain the rights regarding the enforceability of netting, but they will also be obliged to provide information to the Bank, as required, regarding their participation in the FMI to support the Bank's monitoring activities regarding the control of systemic risk.

3.5 Review of Risks Associated with Foreign Participants in Designated FMIs

Authorized foreign banks (i.e., those doing business in Canada through a branch) and other foreign financial institutions may wish to participate directly in Canadian FMIs. Because these entities are subject to the laws of their home jurisdictions, which may differ from those in Canada, there is a risk that their participation could expose the Canadian FMI, its other participants and other linked entities to additional risks.

Under the PCSA, when a foreign institution wishes to participate in a designated FMI located in Canada, the Bank assesses whether the foreign institution's participation could lead to systemic risk in the Canadian financial system or payments system risk to Canadian economic activity, or pose an unacceptable risk to the Bank in guaranteeing the settlement of obligations in the FMI (if applicable). If the Governor is of the opinion that the foreign institution's participation could pose unacceptable risk, he or she may prohibit it from participating or impose conditions on its participation in the designated FMI. As part of this assessment and under the PCSA, foreign entities wishing to participate in a designated FMI located in Canada are required to provide the Bank with a satisfactory legal opinion from their home jurisdiction as to the applicability of foreign laws to their participation in the FMI. The legal opinion should address, among other things, the enforceability of collateral security and netting (if the FMI is a netting system) under the home jurisdiction's laws. The opinion should be prepared in consultation with the Bank and submitted to the Bank well in advance of the time that the authorized foreign institution wishes to start participating in the FMI. The requisite forms of legal opinions for participation in specific FMIs are available from the Bank upon request by authorized foreign banks and other financial institutions wishing to participate in a designated FMI.

3.6 Compliance and Directives

The Bank works with designated FMIs to ensure that any concerns related to systemic risk or payments system risk are understood and addressed by the FMI. If an FMI is not controlling systemic risk or payments system risk to the Bank's satisfaction, the PCSA provides powers to the Governor to direct an FMI to take appropriate action. If the Governor is of the opinion that systemic risk or payments system risk are being, or are likely to be, inadequately controlled by a designated FMI, he or she may issue a directive in writing to the FMI requiring it to cease and refrain from such actions, or to carry out certain actions within a time frame set by the Governor.[8] The Governor may also issue a directive to an FMI's participants with respect to their participation in the FMI if (i) the FMI is not complying with an issued directive; (ii) the FMI has a clearing house located in a foreign jurisdiction; or (iii) the participant(s) actions have resulted in inadequate control of systemic risk or payments system risk in the FMI and those actions are not subject to the rules governing the FMI.

In the event that an FMI or participant fails to comply with (i) the PCSA; (ii) a directive issued by the Governor; or (iii) a binding agreement entered into with the Bank under the PCSA, the Governor may then apply to a superior court for an order directing the FMI or participant to comply.

[8] The Governor requires the consent of the Minister of Finance to issue a directive to an FMI established by or under a statute.