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## A Dual Vision for the Canadian Payments System

### Introduction

Thank you. It is a privilege and pleasure to be here with you today at this important conference.

As many of you know, the Bank of Canada has a strong interest in the evolution of our payments system that goes well beyond our role as purveyor of the simplest form of payment—cash. This interest stems not only from our oversight responsibility for systemically important payment systems under the Payment Clearing and Settlement Act, but also from the important role these systems play in the transmission of monetary policy. Indeed, working with you and other stakeholders to improve payments falls squarely within our mandate to promote the economic and financial welfare of Canada.

Today, I want to share with you a dual vision for Canada's payments system and its oversight. While I won't claim that all of the elements of this vision are original, I hope that by articulating it, we can begin a much-needed dialogue on how to improve our payments system and move it into the 21st century.

Canada's payments system is undergoing rapid and fundamental change. The bulk of it is driven by the combined forces of technological innovation and the desire of consumers to realize the benefits, most notably the convenience, of new technologies.

But is all of this rapid change going in the right direction? Is it sufficiently coordinated? Is it safe? Is it sound? Are users' interests well protected?

These are important questions. And addressing them represents the important challenges we all face.

We must respond—in a coherent and far-sighted manner. Payment systems matter to Canadians. Every year, we make approximately 24 billion payments, worth more than \$44 trillion. These payments not only affect our daily lives, but

they also have a profound impact on the effectiveness of our financial system in promoting economic activity, both here in Canada and externally.

To coordinate our response and ensure that we are progressing in the right direction, we need a dual vision for Canada's payments system and its oversight, one that promotes efficiency-enhancing innovation while managing the risks associated with the adoption of new technologies.

My address today will contain three important elements:

First, a vision for our payments system—one that meets the evolving needs of consumers and businesses and thereby supports productivity growth and improving living standards.

Second, a vision for the oversight of the payments system—one that helps to ensure its safety and soundness, its efficiency and its security.

And third, a coordinated approach for achieving this dual vision—one that calls on the payments industry and regulatory agencies to work together to attain this collective goal.

## A Vision for the Payments System

In considering a vision for the payments system, let's take a holistic perspective.<sup>1</sup> The often-used distinction between retail payment systems, which involve many end-users and smaller transactions, and wholesale or interbank payment systems, may not be appropriate when considering a vision for the future. Instead, a more comprehensive view reflects a future in which technological change will allow retail and wholesale systems to offer similar services and thereby compete more directly for a share of the same payments pie.

My vision for the payments system draws from work that has already been done in Canada and in other jurisdictions to map out a desirable path for the future evolution of payments.

We are not alone in wanting to move toward an innovative, safe and secure payments system that evolves to meet the needs of consumers and businesses. This vision maintains the best characteristics of our legacy system, while allowing for the advantages that innovations promise.

Such a payments system has six essential attributes.<sup>2</sup>

- (i) high speed—end-to-end processing in near real time;
- (ii) low cost—efficient and convenient;

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<sup>1</sup> An example of an all-encompassing definition of a payments system is: a set of “arrangements that allow consumers, businesses and other organizations to transfer value from one party to another. It includes the institutions, instruments and services that facilitate the transfer of value between parties in a transaction.” See Task Force for the Payments System Review, *Going Digital: Transitioning to Digital Payments*, Chapter 1 (n.d.): 8.

<sup>2</sup> These attributes are discussed in: Task Force for the Payments System Review, “The Way We Pay: Transforming the Canadian Payments System” (July 2011); Canadian Payments Association, “CPA Payments Strategy: Vision 2020” (February 2010); The Federal Reserve Banks, “Payment System Improvement —Public Consultation Paper” (September 2013); Reserve Bank of Australia, “Strategic Review of Innovation in the Payments System: Conclusions” (June 2012).

- (iii) open access and ubiquitous usage;
- (iv) improved cross-border functionality;
- (v) safe, sound and reliable; and
- (vi) secure—to protect the private information of users.

I will consider the first four attributes now and leave the last two for the discussion of the vision for oversight.<sup>3</sup>

Comparing Canada's existing payments system to this vision, it is clear there are many gaps.<sup>4</sup> In particular, in this era of instant communication, Canadians expect to be able to send and receive payments faster, at any time, and at low cost, without having to know the recipients' banking information.

Some progress has been made, however.

The wider use of digital payments technology has increased speed, lowered costs and broadened access to the payments market. For example, between 2008 and 2011, the number of credit and debit card payments rose by 23 per cent and 17 per cent respectively.<sup>5</sup> Electronic funds transfers continue to replace cheques for bill payments and payroll transactions.<sup>6</sup>

Although there are fewer users, electronic person-to-person and e-wallet transactions have grown at the impressive rate of about 40 per cent annually over the same period.<sup>7</sup> And then there are the new kids on the block—digital currencies—which, while more limited in market penetration, have the potential to be game-changers by achieving low-cost, faster, end-to-end payments.

These innovations meet the important attributes of speed, convenience, lower costs and efficiency, but fall short when it comes to ubiquity. New payment systems will only realize their full potential when they attain the universal participation that legacy systems enjoy.

Despite many advances, the expression “the cheque is in the mail” is still a reality for many Canadian businesses. The recent Task Force for the Payments System Review highlighted that our businesses are still among the most cheque-reliant of the major economies.<sup>8</sup> What is needed is an electronic invoice and payment system to facilitate the end-to-end automated processing of business-to-business payments.<sup>9</sup>

We also need to improve significantly cross-border payments. An analysis by the Canadian Payments Association (CPA) revealed that international payment

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<sup>3</sup> The use of global payment message standards will help to ensure the necessary information content to facilitate achievement of the first four attributes.

<sup>4</sup> See, for example, Task Force for the Payments System Review, “The Way We Pay: Transforming the Canadian Payments System” (July 2011).

<sup>5</sup> Canadian Payments Association, “Examining Canadian Payment Methods and Trends” (October 2012).

<sup>6</sup> Changes to back-office processes have also led to quicker access to funds.

<sup>7</sup> Canadian Payments Association, “Examining Canadian Payment Methods and Trends” (October 2012).

<sup>8</sup> Task Force for the Payments System Review, *Going Digital: Transitioning to Digital Payments*, (n.d.): 18.

<sup>9</sup> The processing of digital images of cheques is an improvement, but is not the best solution, given available technology.

needs are not currently being met.<sup>10</sup> Compared with domestic payments, cross-border payments involve higher transaction costs and longer processing times associated with converting from one national payment system to another.

To achieve these four important characteristics, our core national payment clearing and settlement systems should be upgraded. The Automated Clearing Settlement System (ACSS) was implemented in the early 1980s, and is showing its age. Access is limited, settlement occurs the next day and end-to-end processing of payments is slow. The Large Value Transfer System (LVTS) was implemented in 1999. It, too, could benefit from technological enhancements to clear and settle *both* retail and wholesale payments more efficiently.

## A Vision for Oversight

To complement this vision for the payments system, we also need a new, more comprehensive vision for its oversight. The arrival of new players in the retail payments market calls for a fundamental overhaul of the Canadian oversight framework. As new systems compete with existing core systems, important public policy issues emerge.

The goal is to create a level playing field for all systems, taking into account that some pose more risk than others. We achieve this through a holistic oversight approach that encompasses three broad types of payment systems:

- (i) systemically important systems;
- (ii) prominent payment systems; and
- (iii) other national retail payment systems.

Such an approach will reinforce the efforts of the payments industry to achieve three important public policy objectives:<sup>11</sup>

- (i) safety and soundness;
- (ii) efficiency; and
- (iii) meeting users' needs and protecting their interests.<sup>12</sup>

Like vital public utilities such as power and water, core national payment systems must be both safe and sound to ensure continuous operations. They must be designed and operated to ensure that risk is effectively managed, using international standards,<sup>13</sup> and providing open risk-based access and ubiquitous coverage. Core systems need to be efficient to remain competitive by keeping costs low. These key attributes will help to ensure that the critical mass of participation required to realize economies of scale and maximize social benefits will be achieved.

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<sup>10</sup> Canadian Payments Association, "CPA Payments Strategy Vision 2020" (February 2010): 8.

<sup>11</sup> See the Canadian Payments Act (S.C. 1996, c. 6, Sch.), available at [laws.justice.gc.ca/eng/acts/p-4.4/index.html](http://laws.justice.gc.ca/eng/acts/p-4.4/index.html).

<sup>12</sup> Users' interests can be defined broadly to include service level expectations, convenience, ease of use, price, safety, transparency of terms of use, privacy and effective redress mechanisms.

<sup>13</sup> International standards for the oversight of systemically important payments systems are defined by the CPSS-IOSCO "Principles for Financial Market Infrastructures" (Committee on Payment and Settlement Systems and Technical Committee of the International Organization of Securities Commissions, April 2012).

The Bank of Canada is working with the Department of Finance to develop a new comprehensive framework for the oversight of payment systems that articulates this vision. It needs to be flexible, forward looking, and risk-based to meet public policy objectives, even as payment systems evolve and new trends emerge.

The challenge is to find the balance between ensuring safety and promoting efficiency. The oversight framework must instill confidence in the payments system and foster innovation and competition to meet user needs, support economic growth and promote financial stability. New players that are not currently subject to the same comprehensive regulatory oversight as traditional incumbents must be brought into the framework.

In this vision, the Bank of Canada may play a larger role by overseeing prominent payment systems, in addition to those that are systemically important.<sup>14</sup> Through this expanded role, within the new oversight framework, we would be able to help maintain a safe and efficient payment infrastructure, even as the market responds to emerging trends and end-user needs.

What would this potential change in the Bank's role mean for the CPA? Initial analysis indicates that the CPA's ACSS exhibits characteristics of a prominent payment system and therefore could be subject to Bank of Canada oversight.<sup>15</sup>

The vision for the other national retail payment systems is that they, too, would be subject to oversight that is proportional to risks. While newer retail systems are not systemically important or prominent, end-user protection is of particular importance. For instance, most collect information about users, which has commercial value. Safeguards should be in place to protect this information.

## Achieving the Dual Vision: Private-Public Collaboration

Now that I have sketched out the dual vision for the payments system in Canada and for its oversight, the next question is: How do we achieve it?

A simple one-word answer would be: Together!

In this context, "together" can have two meanings, but to be successful in moving toward this dual vision, both are important.

Consumers, the payments industry and regulatory agencies all have an important stake in a well-functioning state-of-the-art payments system. All should be consulted. Finding the right solutions and the right balance will require collaboration from all those who have a role in reaching our vision. I trust you

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<sup>14</sup> Prominent payment systems do not pose systemic risk but a disruption or failure could cause, on a national scale, significant disruption to the ability of consumers and businesses to make payments or a general loss of confidence in the overall payments system.

<sup>15</sup> The Bank of Canada could apply standards to prominent payments systems, based on the CPSS-IOSCO "Principles for Financial Market Infrastructures" (CPSS-IOSCO, April 2012). These standards would be adjusted so that they reflect the different nature and magnitude of the risks posed by prominent payments systems.

agree that forums such as this conference, FinPay,<sup>16</sup> and the CPA's Stakeholder Advisory Council should be leveraged for this purpose.

In addition, public sector proposals for changing the regulatory and oversight landscape will go through a public consultation process that will allow constructive input from all stakeholders.

Conferring together is important. So, too, is acting together. If the payments industry can adopt the same standards at approximately the same time, we can maximize the benefits accruing from the positive network effects associated with widely used standardized transactions.

Achieving this will require three additional "c" words beyond consultation: namely, coordination, collaboration and co-operation.

Clearly, the CPA and the public agencies are well placed to help coordinate and encourage collaboration and co-operation by industry.

The CPA and its members can take the lead by embracing new technology to upgrade core clearing and settlement services to enhance efficiency and safety.

The CPA has taken bold—and welcome—steps in this direction by promoting the adoption of the ISO 20022 standards and launching the Next Generation Clearing and Settlement System project.

Using a common standard forms the foundation for any well-designed payment system. Standards such as ISO 20022 facilitate straight-through processing, enhanced business-to-business payments, interoperability, and faster funds transfers for end-users, both domestically and across borders.<sup>17</sup>

Adopting a common standard will also reduce the barriers that prevent new players from using core systems for clearing and settlement.

To be truly successful and to benefit all Canadians, co-operation on the implementation of standards is essential. Giving consumers and businesses what they need and what they want is no easy task, but it is an inescapable one. Those who do not innovate will be left behind in today's globally competitive world.

## Conclusion

Let me wrap up.

Looking ahead, we all want to embrace technological change to improve the payments system in Canada and promote the economic and financial welfare of Canadians. For this purpose, we need a complementary dual vision to guide the changes in both the payments system and its oversight. Innovation is driving a

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<sup>16</sup> FinPay is the Finance Canada Payments Consultative Committee, a forum of public and private sector representatives that advises Finance Canada on developments related to public policy aspects of the Canadian payments system.

<sup>17</sup> Consideration could also be given to the recommendation from the Task Force for the Payments System Review that a centralized digital ID initiative should be further explored as a catalyst to spur innovations such as mobile payments and to leverage e-commerce and the full capabilities of the digital economy. See Task Force for the Payments System Review, "The Way We Pay: Transforming the Canadian Payments System" (July 2011): 16.

rapid evolution—one that requires planning as pointed out more than 10 years ago by my former colleague, James Dingle. He wrote a short book about the history of the CPA titled, *Planning an Evolution*.<sup>18</sup> If we were to write a similar book covering the next 20 challenging, but promising, years in the life of the CPA, we might want to modify the title somewhat to *Planning a Revolution*.

When it comes to monetary policy, the Bank is committed to achieving our 2 per cent inflation target—the best contribution that monetary policy can make to keeping the Canadian economy on a sustainable growth path. In recent months, we have said that economic growth needs to become more balanced and broadly based, with more growth coming through exports and related business investment.

Let me connect this with the vision for the payments system that I've described today: One of the ways we can promote trade-driven growth is to work with our trading partners to reduce substantially the costs of cross-border payments. And, of course, a well-functioning payments system is a crucial element of an efficient financial system, which is, in turn, a key ingredient of sustained economic growth.

As industry and the public sector work together to improve our payments system, we will count on the CPA to continue to play a key role. At this pivotal point in time, we have a once-in-a-generation opportunity to shape the future of Canada's payments system. And we should act on it.

We look forward to continued dialogue and collaboration as our shared vision becomes reality.

Thank you very much.

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<sup>18</sup> J.F. Dingle, *Planning an Evolution: The Story of the Canadian Payments Association, 1980–2002* (Ottawa: A joint publication of the Bank of Canada and the Canadian Payments Association, 2003).