



Consultations on the Criteria and Risk-Management Standards for Prominent Payment Systems: Summary and Responses to Comments Received

On 12 June 2015, the Bank of Canada published a consultation document entitled *Proposed Criteria and Risk-Management Standards for Prominent Payment Systems*. The consultation period ended on 14 August 2015. In the tables below, we summarize both the comments received and the Bank's response. Any standards that are not listed here did not receive substantive comments.

Criteria for identifying prominent payment systems

Proposal The Bank's consultation document cites the oversight framework proposed by the Department of Finance ("Balancing Oversight and Innovation in the Ways We Pay: A Consultation Paper"), consisting of three categories of payment systems:

1. Systemically important payment systems (SIPS)
2. Prominent payment systems (PPS)
3. National retail payment systems (NRPS)

The Bank proposed five high-level criteria for identifying PPS:

- Value of transactions
- Availability of substitutes
- Time criticality of payments
- Centrality
- Interconnectedness

Comments

- While the Bank was not specifically consulting on the three payment system categories, commenters were generally in agreement with the three categories, and there were no specific suggestions in terms of any alternative methodology. In general, they supported a holistic approach to oversight encompassing all payments systems.
- A commenter reiterated the importance of considering the oversight framework with a holistic approach since the payments ecosystem should be viewed as a continuum and therefore should not leave any gaps in oversight. The proposed framework should avoid duplication of oversight.
- However, another commenter suggested that it would be positive to have regulatory overlap. For instance, a system designated as a PPS could also be subject to the NRPS regulation.
- Several commenters requested clarification on the definition of "payments system risk" (including "impact on economic activity" and "general loss of confidence") or the interpretation that would lead to designation as a PPS. One commenter suggested quantitative thresholds.



- One commenter proposed adding “volume” to complement “value” as part of the criteria for identifying PPS.
- One commenter proposed using the term interdependencies instead of interconnectedness.

Response

- There is no intention to change the framework or have duplicative oversight of payment systems. However, the Bank recognizes the importance of ensuring that the three components (oversight of SIPS, PPS and NRPS) are coherent. As a result, the Bank fully expects to establish a coordination mechanism with any entity that is given oversight responsibility for NRPS. Through coordination, certain practices could be required of all payment service providers regardless of their category in this framework.
- The Bank will provide additional clarity regarding the criteria and their relationship to the definition of payments system risk. However, the criteria will continue to be qualitative rather than quantitative. As discussed during the consultation, the Bank is not inclined to establish quantitative metrics for determining whether systems should be designated as a PPS because the criteria should be examined holistically. Specific thresholds (rather than principles-based guidelines) could lead to mechanistic examination of systems, impeding a comprehensive understanding of the potential impact of a failure or disruption of the system, given the nature of the relevant market.
- The Bank agrees that the volume of transactions can also be an important indicator of a system’s ability to cause payments system risk. However, volume must be considered along with the value of transactions being processed and in conjunction with the other criteria. As a result, the Bank agrees to adjust the “value” criteria to include “volume.”
- The Bank agrees with using the term interdependencies instead of interconnectedness.

Bank’s approach to a comprehensive, principles-based oversight framework for PPS

Proposal The Bank proposes a comprehensive, principles-based approach, proportionate to the risks posed.

- Comments**
- In general, commenters were supportive of the principles-based approach, with the exception of one, who considered the framework presented by the Department of Finance, which this consultation builds upon, to be formalistic and piecemeal.
 - Two commenters suggested that the framework and risk-management standards be placed in the context of other controls that limit financial stress (e.g., capital and liquidity rules placed on participants).



- One submission considered there was too much emphasis on safety and soundness issues and not sufficient emphasis on consumer needs and market conduct considerations.
- It was proposed that the standards be adjusted in relation to the type of product (payment instrument) processed by the PPS.
- There was one suggestion to highlight the importance of periodic monitoring to ensure that the standards are enforced and that the industry as a whole is compliant, as well as periodic review of the standards to ensure that they are controlling risk without stifling innovation.
- A commenter stated that there is limited information regarding compliance and enforcement of the risk-management standards, indicating that there is a need for all parties to understand who oversees the PPS, what the process is and how transparent it will be.
- One commenter noted that a similar oversight regime in the European Union does not include standards on credit or liquidity risk.
- There were a couple of commenters who suggested the addition of more risk categories, such as “technological,” “reputational” and “social” risk. One commenter suggested that the key considerations addressing recovery planning (which appear under the standards on the comprehensive risk-management framework and business risk) should be consolidated into a stand-alone standard.

Response

- The standards are intended to be principles-based so that they can be applied to different systems/payments/instruments when relevant, while ensuring consistency and proportionality to address risk. The principles-based approach allows system operators to design and propose specific risk-management approaches that reflect the broader context of risk control in the financial sector.
- Regarding the specific standards in other jurisdictions (namely the European Union), it should be recognized that the criteria to identify payment systems are not directly comparable, which could explain differences in standards.¹ Further, it is the Bank’s judgment that it is prudent to have financial risk-management standards for PPS.
- Technology risk: It is the Bank’s view that risk related to technology is captured in several places in the proposed standards. In particular, “Operational risk” captures issues related to technological problems and “Efficiency and effectiveness” captures issues related to not appropriately reviewing and adopting new technologies that may improve service offerings. The Bank will therefore not add a standard explicitly addressing technology risk.

¹ In the case of the framework developed by the European Central Bank (ECB), there are two categories for retail payments, systemically important retail payment systems (SIRPS) and prominently important retail payment systems (PIRPS). Given these categories and the criteria used to define them the criteria for “PPS” eligibility is not directly comparable to the “PIRPS” category used by the ECB.



- Reputational risk: The commenter indicated that reputational risk may inhibit adoption of certain instruments and reputational issues may affect an instrument regardless of provider (“reputational contagion”). Since the criteria for identifying PPS is intended to identify systems where disruptions can lead to the generalized loss of confidence in the payment systems, the Bank believes that the concerns stemming from “reputational risk” are captured by “payments system risk,” as defined in the *Payment Clearing and Settlement Act*. For such systems, meeting the risk-management standards should mitigate reputational risk.
- Social risk: The commenter indicated that certain vulnerable individuals should more clearly have their views/concerns heard. Stakeholder input and end-user considerations are appropriately taken into account under the “Governance” and “Efficiency and effectiveness” standards. Stakeholder input should include a broad range of views, including those from vulnerable groups.
- Recovery planning: To clarify the importance of recovery planning, the Bank will move its discussion from the standards on the Comprehensive Risk-Management Framework and Business Risk and combine them into a new standard.²
- The Bank’s oversight approach is described on the Bank’s website and will be updated once the criteria and risk-management standards are finalized. The Bank, as the authority granted responsibility for oversight of PPS, will conduct its oversight by working with the operator of any designated system to determine a timeline for meeting the risk-management standards and facilitate an ongoing review to ensure that the standards are being maintained. In terms of transparency, the Bank publishes an annual report on its oversight activities,³ which provides a summary and progress report of oversight priorities for the Bank and for the designated systems for each year. The Bank’s oversight of PPS will be captured in this report.

1. Legal basis

Proposal A PPS should have a well-founded, clear, transparent and enforceable legal basis for each material aspect of its activities in all relevant jurisdictions.

Comments

- One commenter raised concerns that it is not clear who should be able to enforce rules and procedures, which may cause concerns for end-users if rules designed to protect them cannot be enforced.

Response

- Subject to oversight of the Bank of Canada, rules and procedures are enforced by the

² The Bank took this approach when it adopted the PFMI as its risk-management standards for systemically important payment systems.

³ The 2014 report can be found at <http://www.bankofcanada.ca/2015/03/release-2014-annual-report-bank-canada-oversight-activities>.



PPS operator. When there are other legal foundations (e.g., legislation such as the *Bank Act* or the *Canadian Payments Act*) that are crucial to the operation of the PPS, the relevant authority would ensure their enforcement.

2. Governance

Proposal A PPS should have governance arrangements that are clear and transparent, promote the safety and efficiency of the PPS, support confidence in and the smooth functioning of the markets it serves, and support other relevant public interest considerations as well as the objectives of relevant stakeholders.

Comments

- One commenter requested that major operational and strategic decisions be limited to direct and indirect participants (because these entities have the financial and fiduciary interest), while keeping all stakeholders informed.
- Another view maintained that all stakeholders (including end-users) should be involved in the fundamental decision-making process and suggested reinforcing stakeholder participation measures.
- There were also proposals to include more specific guidelines regarding the composition of a PPS's board of directors so that it reflects the nature of the organization.

Response

- The Bank's view is that all stakeholders, including end-users (beyond direct and indirect participants), should be afforded effective means to provide input to major decisions and bring concerns to the attention of the PPS operator. The Bank believes that effective means of input for stakeholders are included under the requirement that "the PPS's design, rules, overall strategy and major decisions appropriately reflect the legitimate interests of its direct and indirect participants and other relevant stakeholders." There would therefore be no need to alter the language used in the "Governance" standard.
- The PPS operator can design funding plans (generally or for specific projects) that distribute costs of implementation across those entities that will use or benefit from the project (which may not only be the direct and indirect participants).
- The Bank agrees that the board composition, as well as the individuals on the board, must have the appropriate experience, mix of skills and integrity to fulfill the role. However, the Bank suggests that the language in the principle adequately reflects this requirement and does not need to be adjusted.



4. Credit risk

Proposal A PPS should effectively measure, monitor and manage its credit exposures to participants and those arising from its payment clearing and settlement processes. A PPS should maintain sufficient financial resources to cover its credit exposure arising from the default of the participant and its affiliates that would generate the largest aggregate credit exposure for the PPS in extreme but plausible market conditions.

Comments

- One commenter requested clarification on whether “extreme but plausible market conditions” could be interpreted differently for PPS than it is for SIPS.
- A couple of commenters questioned the need to require ex-ante financial resources in the case that the Automated Clearing Settlement System (ACSS) is designated as a PPS. One of them considered the risk controls in the Large Value Transfer System (LVTS) to provide sufficient resources to cover shortfalls in severe stress events, while the other suggested seeking alternatives that are better suited to the needs of PPS participants.

Response

- The Bank agrees that the “extreme but plausible market conditions” considered for PPS should be different than those for SIPS. The conditions should be relevant to the PPS market; however, a PPS operator need to define what a relevant extreme but plausible market condition is for the system and establish the credit-risk-management controls based on this scenario.
- Collateralization in the LVTS does not protect against intraday and overnight credit exposures in the ACSS or against participants defaulting on their ACSS settlement payment.

5. Collateral requirements

Proposal A PPS that requires collateral to manage its credit exposure or the credit exposures of its participants should accept collateral with low credit, liquidity and market risks. A PPS should also set and enforce appropriately conservative haircuts and concentration limits.

Comments

- One commenter proposed that collateral requirements be set for each participant based on individuals risk profiles (such as type of institution, regulatory regime, capitalization ratios, volumes or type of transaction).

Response

- Since the Bank’s risk-management standards are principles-based, the PPS operator will propose a specific credit-risk-management model, which includes collateral requirements. The Bank will review the methodology for setting collateral requirements to verify that it meets this standard.



6. Liquidity risk

Proposal A PPS should effectively measure, monitor and manage its liquidity risk. A PPS should maintain sufficient liquid resources in all relevant currencies to effect same-day and, when appropriate, intraday and multi-day settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate liquidity obligation for the PPS in extreme but plausible market conditions.

Comments

- A commenter claimed that the requirement for assets with “a high degree of confidence” for collateral is too high; however, no specific alternative was proposed.
- A commenter indicated that the list of qualifying liquid resources has been reduced from that currently eligible for the LVTS.

Response

- The Bank suggests that “a high degree of confidence” is needed to appropriately manage the credit and liquidity risks; however, the specific value that would be considered a sufficiently high degree of confidence could be influenced by the nature of the risk relevant to the PPS. As a result, what is considered a high degree of confidence for PPS could be different than those considered for SIPS.
- The proposed list of eligible liquid resources was altered for simplification purposes only, given that some liquid resources are unlikely to be applicable to PPS. The Bank will refer to the list of qualifying liquid resources outlined in the PFMI for PPS.

7. Settlement finality

Proposal A PPS should provide clear and certain final settlement by the end of the value date. When necessary, or preferable, a PPS should provide final settlement intraday or in real time.

Comments

- Commenters supported the proposed approach in general.
- One of the commenters agreed on the objective of intraday settlement while raising objections about striving for a real-time settlement.
- One commenter requested that the scope be expanded to include extended recourse for some items needed for debit-pull transactions.
- One commenter raised concerns with the term “value date,” indicating that system operators and/or financial institutions can, in some cases, unilaterally select the value date to be later than when the payment was executed.



- Response**
- The Bank agrees that real-time settlement is not practical or necessary in all circumstances. The nature of the instrument, the risks and the needs of end-users should influence decisions regarding the speed of settlement. To address this concern, the Bank will clarify that, when necessary, a PPS should provide final settlement intraday or in real time to support the technical requirements or end-user needs for specific instruments.
 - The Bank agrees that many retail payment instruments require a framework for recourse to reverse or contest payments. Based on the comments received, the Bank will clarify the standard that indicates “A PPS’s rules and procedures should clearly define the point at which settlement is final” to specify that this should include clear rules regarding the process and timelines for recourse, including the conditions under which recourse is permitted.
 - The intent is that transactions be processed on the date expected by end-users and there is transparency in this regard. This concept will be clarified.

12. Operational risk

Proposal A PPS should identify the plausible sources of operational risk, both internal and external, and mitigate their impact through the use of appropriate systems, policies, procedures and controls. Systems should be designed to ensure a high degree of security and operational reliability and should have adequate, scalable capacity. Business-continuity management should aim for timely recovery of operations and fulfillment of the PPS’s obligations, including in the event of a wide-scale or major disruption.

- Comments**
- A couple of the commenters found the two-hour recovery time requirement to be too stringent. They requested more flexibility in setting a longer time horizon to re-establish operations or to implement contingencies or provisions covering a force majeure. Another proposal suggested a graduated scale linked to the severity of the disruption to establish a range of recovery times.
 - For the French version, there was a suggestion to replace “garantir” with “assurer” throughout this standard.

- Response**
- Operational risk is an important risk in PPS because operational disruptions can affect the ability of end-users to send payments as well as confidence in the Canadian payments system and other interconnected systems. However, the Bank will clarify that “recovery” should be sufficient to mitigate the disruption to end-users and other dependent systems and maintain same-day settlement. For example, sufficiently robust contingency procedures that limit the delay to settlement would represent satisfactory recovery for a PPS facing an extreme disruption.
 - The Bank agrees that “assurer” better reflects the intent of the standard and thus will



replace “garantir” in the French version of these standards.

13. Access

Proposal A PPS should have objective, risk-based and publicly disclosed criteria for participation that permit fair and open access.

Comments

- In general, the comments supported the proposal.
- One commenter requested more clarity about the Bank’s expectation regarding “fair and open access” and how the standard would be applied.

Response

- The Bank’s interpretation of fair and open access is similar to that used for SIPS: access requirements should not restrict participation for reasons other than controlling risk. Fair and open access can support competition, efficiency and innovation. The Bank believes that the detail provided in the key considerations included in the proposed standards provide further guidance for interpreting the expectations regarding access criteria.

15. Efficiency and effectiveness

Proposal A PPS should be efficient and effective in meeting the requirements of its participants and the markets it serves, with a particular consideration for the interest of end-users.

Comments

- One commenter suggested that effectiveness could be improved by mandating that the system’s rules meet the needs of the market, participants and end-users.

Response

- Under the proposed standards, the governance framework must support confidence in and the smooth functioning of the markets served by the PPS and promote the objectives of relevant stakeholders. It is the Bank’s view that this effectively requires that the PPS meet those objectives through its system design, rules and other relevant arrangements.

Implementation

Proposal The Bank proposed working with system operators to determine a reasonable timeline to meet the proposed standards.

Comments

- Commenters agreed with the proposed approach in general.



- One commenter proposed a measured approach to leverage the international experience related to standards for non-systemically important payment systems.
- Participants in the ACSS expressed some concern about the changes and upgrades to systems that would be required if the ACSS were designated. They suggested allowing for a deferred implementation approach by system participants, in tandem with ACSS changes implemented by the Canadian Payments Association (CPA).
- Another commenter challenged the usefulness of making changes to the ACSS if the new platform developed under the Next Gen project is expected to eventually replace the ACSS. The new system would have to meet the new PPS standards from the outset.

Response

- The Bank reviewed international practices when developing the proposed criteria and risk-management standards. There are currently neither internationally agreed-upon standards for PPS-type systems nor are there plans to develop any. As a result, the Bank deems it appropriate to move forward with its own framework for oversight of PPS without awaiting further international developments.
- As part of determining a reasonable timeline for the ACSS to meet the risk-management standards, if it is designated, the Bank expects to take into consideration the changes that would be needed from participants as well as any ongoing plans for modernization. As a result, while the Bank will expect some standards to be met in the short term, it will allow others to be addressed through the CPA's modernization plans and timeline.