

The Bank of Canada is gathering information from industry and stakeholders to enhance its understanding of the retail payment services ecosystem. This document, including any scenarios, diagrams, and questions, is intended to improve the Bank of Canada's understanding and should not be construed as indicative of any potential legislative or regulatory options.



BANK OF CANADA
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Retail Payments Advisory Committee

End-User Fund Safeguarding

February 12, 2020

The key objectives of safeguarding end-user funds as proposed by the Department of Finance are to mitigate the following risks for end users:

- **Liquidity Risk:** where a PSP fails to hold sufficient funds in safe and liquid investments to fulfil its payment obligations or end-user demands to withdraw their funds; and
- **Insolvency risk:** where a PSP fails to properly isolate end-user funds from its own assets, which could result in these funds being made available to other creditors should the PSP become insolvent.

The following discussions are focused on the mitigation of insolvency risk. Other topics within the issue of end-user fund safeguarding, including the mitigation of liquidity risk, will be discussed at another time. The scenarios outlined, as well as the questions posed below, are to help improve the Bank of Canada's understanding and should not be construed as indicative of any legislative or regulatory options.

Session 1: Protecting End-User Funds from a PSP's Insolvency

For the purposes of this session, consider a PSP that holds its end users' Canadian dollar funds at a Canadian financial institution (i.e., the PSP does not rely on another PSP to hold end-user funds).



1a. Trust account

One of the objectives of safeguarding end-user funds is to ensure that in the event of a PSP's insolvency, the end-user funds are isolated from the PSP's own assets such that the funds would not be made available to other creditors.

One of the ways to achieve this objective is for the PSP to hold the end-user funds "in trust". The Bank of Canada understands that one way this could be achieved is by the use of a trust account, as outlined in the Department of Finance Canada's 2017 Consultation Paper, [A New Retail Payments Oversight Framework](#).

1. Do you currently hold end-user funds in a trust account?

a. If funds are not being held in a trust account, are there impediments to you doing so?

2. Are you holding end-user funds “in trust”? If so, what financial product(s) are you using?
 - a. If funds are not being held in trust, are there impediments to you doing so?

In the 2017 Consultation Paper, the Department of Finance Canada considered requiring PSPs to comply with necessary requirements to ensure that separate trust coverage is provided for each end user as beneficiaries of the trust.

The Bank is not aware of PSPs’ existing practices. However, the Canada Deposit Insurance Corporation’s (CDIC’s) new amendments in its Act/By-laws (which are not in force) speak to specific requirements for an entity seeking to become a professional trustee.¹ While not proposed in the 2017 Consultation Paper, these requirements would seem like a way to prompt a discussion on existing practices.

As a professional trustee, an entity would be able to obtain federal deposit-insurance coverage up to CDIC’s maximum of \$100,000 for each end user rather than for the account as a whole.

Based on the current amendments not in force, these requirements at a high level include:

- Maintaining records of each beneficiary’s (end user’s): (i) name, (ii) address, and amount of funds being held; and
- Providing the CDIC member institution (i.e., FRFI) updated contact information.

Provincial deposit insurance regimes offered through a provincially regulated financial institution (e.g., a credit union) may have similar requirements. Regardless of federal or provincial deposit insurance requirements, the Bank would like to understand current record keeping practices with respect to end-user funds.

3. What are your current record-keeping practices? Do they meet the requirements to obtain deposit insurance coverage for each end user instead of the account as a whole?
4. Are there impediments other than record keeping requirements that prevent you from obtaining deposit insurance coverage for each end user?
5. What record-keeping requirements might PSPs be following in other jurisdictions?

1b. Private Insurance

In previous engagements, the Bank of Canada has received feedback from some PSPs that trust accounts (and banking accounts more generally) can be difficult for many PSPs to obtain. The UK’s Payment Services Regulations address a similar concern by leveraging private insurance policies.²

¹ See <https://laws-lois.justice.gc.ca/PDF/C-3.pdf>, CDIC’s web site notes April 30, 2021 as the date that the amendments are expected to come into force. See: <https://www.cdic.ca/newsroom/cdic-articles-and-updates/changes-to-canada-deposit-insurance-framework/>

² The PSR bring into force in UK law the EU’s second Payments Services Directive (PSD2). The PSR includes provisions with respect to safeguarding requirements for end-user funds. Under these requirements, PSPs that safeguard end-user funds with private insurance are required to have a trust account (at all times) to deposit the proceeds of their insurance contract should the PSP become insolvent.

For such an option to meet the stated objectives mitigating insolvency risk, the insurance policy could seek to ensure:

- The insurance policy covers, at all times, 100% of end-user funds held by the PSP that has become insolvent;
- The insurance policy is triggered by the PSP’s insolvency event; and
- Proceeds of the insurance are ultimately paid out to end users.

The Bank of Canada is not aware of any such private insurance product available in Canada to meet these needs.

6. Are you aware of any PSPs in or outside of Canada that use insurance to safeguard end-user funds (e.g., in the UK)?
 - a. If so, are you aware of the key characteristics of these policies?

1c. Insurance Equivalent (e.g., a Guarantee)

The UK’s Payment Service Regulations also provides the option of safeguarding end-user funds by having the PSP obtain a bank guarantee. This option may achieve the same objectives as the insurance policy. Some form of financial guarantee could be an option, if the guarantee:

- Covers, at all times, 100% of end-user funds held by the PSP that has become insolvent;
- Is triggered by or claimed following the PSP’s insolvency event; and
- Ensures end-user funds are paid out in whole and directly to end users.

7. Do you know if any PSPs are using such a product to safeguard end-user funds from the insolvency of the PSP?
8. Are you aware of any other types of products that are available to safeguard end-user funds (for example: a parental guarantee, a financial derivative contract)?
9. If you had to seek such a product, how would you go about doing so?

1d. Other methods

10. What other methods are PSPs currently using to hold and protect end-user funds?

Session 2: PSPs’ Current Practices for Holding Funds

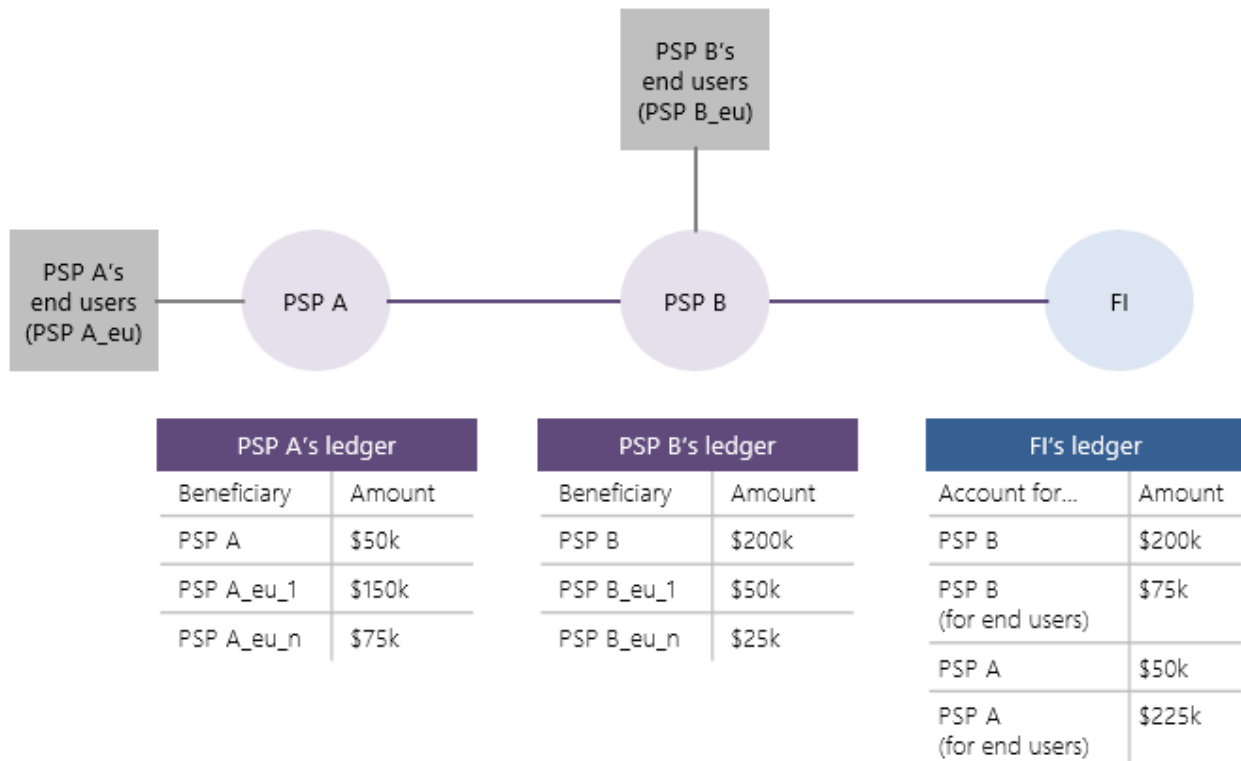
Session 2 focuses on two examples of end-user fund-holding practices that the Bank of Canada wishes to learn more about. The examples provided are meant to illustrate a possible current practice and the proposed questions are meant help the Bank of Canada better understand current practices.

Section 2a considers situations where a PSP relies on another PSP to access banking services to hold end-user funds. Section 2b considers a PSP holding end-user funds that are not denominated in Canadian dollars.

2a. Tiered Arrangements in Holding End-User Funds

To explore a tiered arrangement in holding end-user funds, Session 2a focuses on the following structure:

- PSP A cannot access banking services at a financial institution;
- PSP B can access banking services and facilitates PSP A’s ability to hold funds at the financial institution; and
- PSP B has its own end users, distinct from PSP A’s end users.



This illustration assumes that PSP B creates four accounts, one each for: (i) its own operating funds, (ii) its own end users, (iii) PSP A’s operating funds, and (iv) PSP A’s end users.

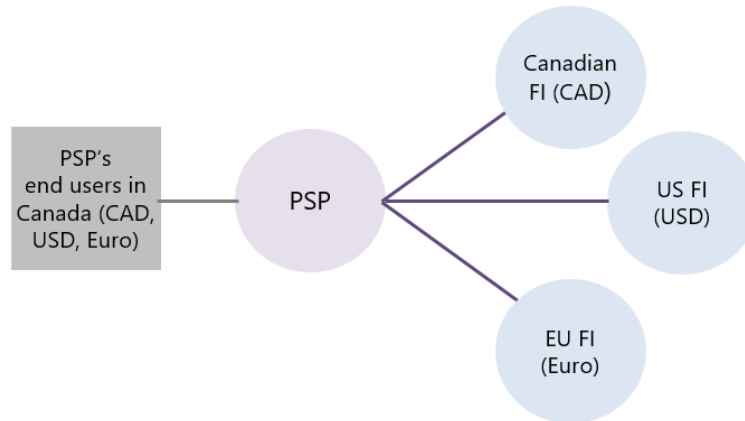
11. Do you know of any PSPs, that are not themselves a regulated FI, facilitating another PSP’s access to an FI to enable that PSP to hold end-user funds?
 - a. Are there structural barriers in the facilitation of this access (e.g., FIs do not allow the creation of a separate bank account for another PSP)?
12. If PSP B were to hold funds for PSP A, how would it do so? Would PSP A’s end-user funds be segregated from PSP B’s end users’ funds?

2b. Foreign End-User Funds

The 2017 Consultation Paper indicated that the scope of the framework would apply to fiat currencies and did not limit the application to CAD. Thus, it is possible that the Bank would supervise PSPs that hold funds for end users that transact in foreign currencies.

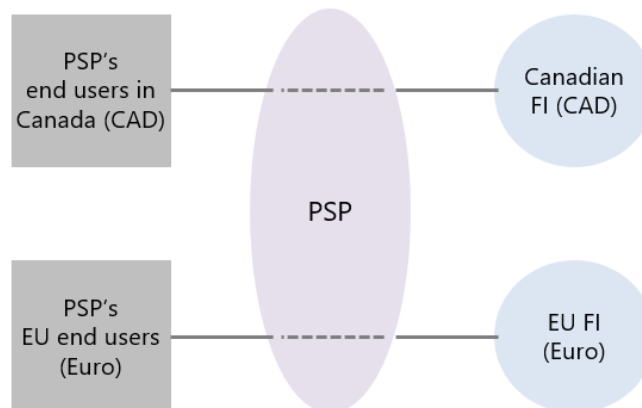
To better understand these types of situations, the Bank of Canada has outlined two possible practices of holding foreign currencies. Scenario 1 hypothesizes a potential practice of a PSP offering multi-currency services for end users in Canada. Scenario 2 considers the potential practice of a PSP holding both CAD funds for end users in Canada and foreign funds for other end users in foreign jurisdictions.

Scenario 1: PSP offers multi-currency service and holds several currencies for end users in Canada



13. In this type of service, where are foreign (fiat) currency funds typically held (e.g., Canadian FI or non-Canadian FI)? What are some drivers for determining where these funds are held?
14. How would end-user funds (CAD and foreign) in this scenario be protected from PSP insolvency? Does this differ if the funds are held at a Canadian FI vs. a non-Canadian FI?

Scenario 2: PSP holds only CAD funds for end users in Canada, and also foreign funds for end users in a foreign country



15. Do you hold end-user funds for end users in multiple jurisdictions (e.g., funds held outside of Canada for end users who are also outside of Canada)? How do you safeguard these funds?
16. Are you aware of any PSPs experiencing conflicting end-user fund safeguarding requirements in multiple jurisdictions?
 - a. If so, how are PSPs dealing with this?