

Public Consultation Report: Interim Retail Payments Advisory Committee (RPAC)

February 12, 2020

Summary

The Interim Retail Payments Advisory Committee (RPAC) held its first meeting on February 12, 2020. In addition to setting out the Terms of Reference and the procedures of the Committee, members discussed current business practices for the safeguarding of end-user funds. Participants indicated that:

- clarification was needed for what it means to hold funds,
- the objectives of safeguarding end-user funds is important, particularly in the event of a PSP becoming insolvent, and
- optionality is required to ensure safeguarding of end-user funds for various business models.

Who we consulted		
<p>Participants:</p> <ul style="list-style-type: none"> • Bank of Canada • Department of Finance • Moneris • Nanopay • Paypal • Paytm • Square • STACK • Telpay • TransferWise • Western Union • Visa 	<p>Method of engagement:</p> <p>In person</p>	<p>Purpose of engagement:</p> <p>To facilitate the Bank of Canada's understanding of the retail payments ecosystem and current business practices.</p>
What we asked		
<ul style="list-style-type: none"> • The key objectives in protecting end-user funds as outlined in the Department of Finance's 2017 consultation paper on a New Retail Payment Oversight Framework, are to protect against: 1) liquidity risk, and 2) insolvency risk. • In the meeting, participants were asked about potential methods to mitigate against 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. <ul style="list-style-type: none"> ○ How are participants currently safeguarding end-user funds? ○ What are current record-keeping practices? What are some impediments to record-keeping with respect to end-user funds? • UK Payment Service Regulations leverages private insurance as a method to protect end-user funds. To adequately mitigate Insolvency Risk, insurance should: 1) cover, at all times, 100% of end-user funds held by the PSP; 2) trigger in the event of the PSP's insolvency event; and 3) ensure proceeds of insurance are ultimately paid out to end users. <ul style="list-style-type: none"> ○ Would private insurance be a viable option for safeguarding end-user funds in Canada? • What are some other options for safeguarding end-user funds that participants use that could ensure end users can receive their funds in the event of a PSP's insolvency? • Do participants currently engage in tiered-arrangements for holding end-user funds (i.e., one PSP holding another PSP's funds at a financial institution)? • Do participants currently hold funds in multiple currencies? How are these funds safeguarded? 		

- **Do participants currently have end users in multiple jurisdictions? If so, how are funds safeguarded in different jurisdictions?**

What we heard

- Participants indicated they were unclear what constituted the payment function of “holding funds”. There was confusion about when obligations regarding holding funds begin and end.
- There was broad support for the objective of safeguarding end-user funds, especially that funds should be protected in the case of a PSP’s insolvency.
- Participants raised concerns about what kind of accounts would meet the legal definition of a trust account.
 - Some participants are holding funds in a manner equivalent to “in trust” and consider it sufficient to protect the funds in the event of their insolvency.
 - Some participants disperse funds to end-users, (e.g., pre-funding merchants, prior to receiving funds from end-users) which creates practical difficulties for holding funds in a trust account. This practical concern did not apply to funds being held overnight. This concern aligns with confusion about the definition of “holding funds”.
- Record-keeping practices varied among participants and typically depend on whether a participant is registered as a money service business (MSB) and therefore subject to record-keeping requirements.
 - It is often difficult for participants to validate the data received and it is difficult to obtain current data from end-users.
 - Could be costly and difficult for those who are not currently MSBs or smaller PSPs to start detailed record-keeping practices.
 - Participants often stagger their record gathering to make on-boarding to their services more user-friendly. Only an email may be required to sign up for the service, but more information would be required before funds can be transferred.
- Participants indicated private insurance for safeguarding end-user funds, similar to the requirement from the UK, could be a good bridging option for a longer-term solution.
 - Participants noted that this was a very expensive option in the UK and may require authorities to work with the insurance companies to develop the appropriate products
 - In general, participants agreed with the proposed objectives that the insurance should meet in order to protect end-user funds against the PSP’s insolvency.
- Participants noted that optionality is important to effectively safeguard end-user funds. In addition to holding funds in trust in a trust account and private insurance, PSPs also noted some other options that are in use or could be used to safeguard end-user funds
 - Publicly traded company exemption;
 - Parental guarantee (possibly in conjunction with other requirements);
 - Irrevocable letter of credit;
 - Collateral accounts (if the account were not in the name of the PSP itself);
 - Prescribed capital ratios and physical holding requirements; or
 - “For-the-benefit-of” accounts or client accounts.
- The intricacies of how PSPs function (e.g., acquirers, processors) should be taken into account when setting requirements for holding and safeguarding end-user funds
- Participants noted that there are issues for PSPs with respect to accessing banking services (e.g., trust accounts). This would need to be addressed for some options to become viable.
- Participants indicated that allowing PSPs to become members of CDIC would be a viable and, for some participants, preferable method of achieving the objectives of end-user fund safeguarding.
- On tiered arrangements for fund holding, participants indicated:

- It is not a common business practice currently, but it does exist, and participants could see it becoming a bridge to getting better banking relationships for newer and smaller PSPs;
 - Currently a tiered arrangement is more common for access to payments systems or in the capacity as an acquirer, but not for holding funds;
- In general, there would be a lot of risk for the PSP who offers to hold funds at the financial institution. The anti-money laundering reporting and record-keeping obligations would be significant;
- If tiered arrangements were to happen, participants felt that both PSPs would benefit from having clear delineation in record-keeping roles and responsibilities; and
- Participants noted that if it were to happen, it is unlikely the PSP holding funds at the financial institution would open separate accounts or that the financial institution would keep distinct ledgers.
- Participants noted that typically funds are kept onshore in the currency of the jurisdiction of safeguarding. However, this is largely based on the specific regulations of the jurisdiction the PSP operates in.
 - Some participants noted that multi-currency accounts can be costly and in practice it may be that funds held are reduced to one or two currencies.
- In general, participants noted that it is unlikely for a PSP to operate within a given jurisdiction without incorporating in that jurisdiction (for example, a Canadian PSP operating in the EU without having an EU affiliate).
- Participants noted that they are not aware of any conflicting requirements within various jurisdictions for the safeguarding of end-user funds.
- Participants noted that whether the Retail Payments Oversight Framework requirements should apply should not be solely based on whether the PSP is located in Canada, but rather should depend on whether they are carrying on payment service business in Canada.
- Participants noted that in cases where a Canadian PSP has both Canadian and foreign clients and the funds are held both in Canada and elsewhere, there should be clear record-keeping requirements to track funds and safeguarding practices.
 - Participants noted that if the funds held for end-users outside of Canada can be separated and held in other jurisdictions and if these funds outside of Canada do not introduce risks to the Canadian payment systems, financial institutions, or entities, then they should not be covered under RPOF requirements.

What happens next

- The Bank of Canada will support Finance Canada in developing regulatory options for safeguarding end-user funds under the Retail Payments Oversight Framework. The Bank of Canada will research current practices identified by PSPs for safeguarding end-user funds to verify whether they meet the objectives of the Retail Payments Oversight Framework.
- The Bank of Canada will work with Finance Canada to understand the policy intent and to clarify the definition of “holding funds”.
- The Bank of Canada will reference this document throughout the development of its supervisory approach with respect to end-user fund safeguarding requirements, and will communicate further on the information and concerns provided, as necessary.
- The Bank of Canada will continue to engage with stakeholders, including the retail payment industry, other regulators, government agencies, and consumer groups, to better understand the current practices and concerns with respect to end-user fund safeguarding.