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

October 28 – 29, 2020

Summary

The Interim Retail Payments Advisory Committee (RPAC) held its fifth meeting on October 28 and 29, 2020. Participants had their first opportunity to provide feedback on a set of possible expectations on end-user fund safeguarding and operational risk management.

Who we consulted

Participants:	Method of engagement:	Purpose of engagement:
• Bank of Canada • Department of Finance • Moneris • nanopay • PayPal • Paytm (regrets) • Square • STACK • Telpay • TransferWise • Visa (regrets) • Western Union	Virtual (Webex)	To provide feedback on a set of possible expectations that may apply to PSPs' end-user fund safeguarding practices and operational risk management.

What we asked

- Participants were asked to share concerns or views on structural or operational barriers that may prevent PSPs from meeting the set of potential expectations on end-user fund safeguarding and operational risk management.
- Detailed content on possible expectations can be found in the discussion note for this event.

What we heard

End-user fund safeguarding expectations

- Participants supported the three overarching goals of end-user fund safeguarding: segregation of end-user funds, protection of end-user funds, and reliable access to funds by end users.
- No major concerns were raised regarding the following potential expectations:
    - The use of a separate account solely for holding end-user funds;
    - The account, insurance, and guarantee providers needing to be prudentially regulated;
    - The expectation to conduct due diligence assessments of financial institutions that provide functions in relation to storing and safeguarding end-user funds; and

- How the expectations could apply to a tiered arrangement where one PSP relies on another PSP for access to banking.

- It was noted that end-user funds are often held in trust, but not in a trust account.
    - Holding end-user funds in trust accounts would be costly and may not be possible for PSPs in some cases.
    - Additionally, some jurisdictions make end-user funds held by PSPs bankruptcy-remote through the application of specific laws, rather than relying on trust laws.
- Specifying the exact class of insurance or type of guarantee could make such expectations obsolete as the market for such financial products is likely to evolve over time.
- Some participants noted the possibility of designating a regulatory authority as the beneficiary of the insurance or guarantee contract rather than the end users.
- In the context of how PSPs could be prohibited from relying on insurance or guarantee providers that are affiliates or parent companies, some participants raised that wrong-way risk in such circumstances may be managed to some degree if the insurance or guarantee provider is a prudentially regulated financial institution.
- It may be possible to obtain a financial guarantee from a financial institution in Canada that would pay out the funds (belonging to end users) in a currency different from Canadian dollars.
- Restricting PSPs to rely on financial institutions that are authorised in a limited set of jurisdictions is viable, however:
    - The same objective could be achieved by restricting PSPs to rely on financial institutions that are prudentially regulated and thus financially resilient; and
    - Too restrictive of a requirement on who PSPs could select as banking partners may further aggravate the existing concerns around the lack of access to banking by PSPs.
- Participants suggested the possibility of applying end-user fund safeguarding expectations only to amount of funds that are larger than a particular threshold.

Operational Risk Management

- Alignment with expectations in similar regimes in other jurisdictions and expectations for other types of financial institutions in Canada would be beneficial.
- Clarification of certain terms and topics was requested, including:
    - How the expectations would apply to PSPs that form part of an international group, in particular where operational risk management policies and procedures are set by a parent company and applied across its subsidiaries, or where certain roles and responsibilities might sit with a parent company outside Canada.
    - The definition of "plausible", for PSPs to better understand the scope of operational risks to be identified as part of the operational risk and incident response framework;
    - What a PSP might be expected to cover in an "annual review" of its operational risk and incident response framework;

- The concept of materiality in operational risk management (e.g., with respect to risks, incidents, testing, third-party service providers); and
  - How proportionality might be used within the regime.
- Allowing for some degree of flexibility in certain aspects of the expectations was beneficial. Examples noted by participants included:
  - Approval processes for operational risk management policies and procedures;
  - Setting of availability targets;
  - Escalation processes in the event of an incident; and
  - Approaches that could be used in testing elements of the operational risk and incident response framework.
- Participants discussed whether a requirement to conduct comprehensive testing of the operational risk and incident response framework over a three-year period was reasonable. It was suggested that taking a risk-based, or materiality-based, approach could alleviate resource pressures in this area.
- With respect to audits, participants would welcome the ability to rely on audits conducted for other purposes (e.g. certifications) to meet requirements under the Retail Payments Supervisory Framework.
- A requirement to conduct audits could be cost prohibitive for small PSPs.
- Clarity on what must be covered in due diligence assessments of third-party service providers, and what scope of third-party service providers should be covered (i.e., would there be a materiality consideration?).
  - The B-10 Guideline by the Office of the Superintendent for Financial Institutions was raised as an example to reference.
  - The ability of smaller PSPs to conduct due diligence on third-party service providers may be limited.
- PSPs may need time to come into compliance on certain expectations. This could include expectations with respect to conducting due diligence across all of a PSP's existing third-party service providers.

What happens next

- The Bank of Canada recognises that participants shared strong views on expecting PSPs to use trust accounts, and that there may be other mechanisms to make end-user funds bankruptcy remote to achieve the policy objective of protecting these funds in the case of a PSP's insolvency event.
  - Participants are invited to share detailed information on these approaches in writing. Participants are welcome to send this to the RPAC email address.
- There will be more opportunities in the future for participants, and the industry more broadly, to share views and concerns on end-user fund safeguarding and operational risk management expectations.