Retail Payments Advisory Committee – Approach to Fees

16 and 17 November 2021 |

This note is provided to assist participants in preparing for the Retail Payments Advisory Committee (RPAC) meeting in November 2021, which will discuss a preliminary approach to fees.

Under the *Retail Payment Activities Act* (RPAA), the Bank of Canada (Bank) is required to recoup costs incurred to carry out its mandate of supervising payment service providers (PSPs) through two types of fees: a fee associated with an applicant's registration application and an annual assessment fee from registered PSPs.

Building on this legislative direction, this document outlines high-level components of a preliminary approach to the design of these fees. **Please note, these components are still in development, and are subject to change based on the policy and regulatory development process, future consultations with a broader group of PSPs, as well as other policy considerations. Ultimately, the Government is responsible for proposing regulations made under the RPAA, including in relation to fees.**

It is the Bank's understanding that the Government intends for the framework under the RPAA to foster competition and innovation. Therefore, cost prohibitive fees that could be a financial barrier to entry would run counter to the Government's intent. Annex 1 of this document provides illustrative examples of estimated annual costs to be recovered through fees under the RPAA. These costs and fee amounts are provided for the sole purpose of guiding the discussion with stakeholders on an approach to fees, and should not be viewed as amounts that will be prescribed in regulations in relation to fees.

Principles

From the Bank's perspective, fees under the RPAA should reflect four overarching principles:

- **Transparency** – to provide the industry and the public a sufficient degree of clarity about how the Bank intends to recover costs, as well as clear information on how these costs would be allocated in a given calendar year;
- **Simplicity** – to avoid creating an overly complicated cost allocation approach so that administrative costs are minimized and the industry/public is able to easily understand the fee approach;
- **Predictability –** to enable PSPs to anticipate or calculate the fees they may face ex-ante; and
- **Fairness** – to have fees that reflect the level of supervisory effort, as well as considerations for the potential undue financial burden placed on PSPs.

Costs to Recover

The annual cost base to recover will be calculated through a systematic approach, derived by totalling both direct and indirect costs of all functions that implement or support the Bank's PSP supervisory activities.

This calculation will determine the total cost of retail payments supervision for the Bank (as per subsection 99(1) of the RPAA) and will represent the total amount that the Bank will collect from registered PSPs each year. For clarity, costs incurred by the Department of Finance Canada or other designated entities for national security reviews will **not** be part of the cost to be recouped by the Bank.

Total Fees Charged

The intent set out in the RPAA is to recover the Bank's supervisory costs in a given calendar year through the sum of the fees collected at registration application and the assessment fees collected from all registered PSPs .

Fee 1 of 2: Fee at Registration Application

All applicants for PSP registration will need to pay a fee (as per subsection 29(2) of the RPAA) as part of its application, and the Bank will only review an application once it has received this fee.

The Bank's preliminary view is that this fee amount should be equal to the Bank's costs of assessing an applicant's registration application, including both direct and indirect costs. By doing so, each applicant would be bearing the costs associated with their application being evaluated by the Bank, and therefore the fee should be considered fair.

The Bank recognizes that the fee at registration application could be considered as the financial cost to enter the financial ecosystem as a PSP. So, a lower fee could lower the financial barrier of entry to register as a PSP. However, by lowering the fee for registration application, more registered PSPs would be subsidizing the costs associated with assessing these applications.

Based on preliminary estimates, this cost, or average level of effort for the Bank, is approximately $2,500 per registration application, which could be prescribed in regulations pursuant to the RPAA. This fee amount may not be modified frequently, outside of prescribed adjustments based on inflation, and any changes to it would likely need to be sufficiently material to follow up with a change in regulations.

This fee is envisioned to be non-refundable, even if it is determined that an applicant is not a PSP or is ineligible for registration, as the purpose is to recoup costs associated with evaluating a registration application, regardless of the outcome of that evaluation. As discussed in the September 2021 RPAC discussion note on registration process, the Bank envisions establishing a registration screening process where an entity could check whether or not they should go through the registration process. There will be no fee associated with this screening process.[1]

Charging different types of PSPs a different fee at registration application has also been considered but deemed a non-option, because it would be unfair to PSPs that are charged a higher amount for their registration application when the work associated with the assessment would not depend on the "class" of

[1] If an entity is advised to proceed with the registration application process, they will be directed to the appropriate form to complete and be prompted to pay the fee at registration application.

PSP. Additionally, there are practical concerns with classifying PSPs prior to evaluating the registration application, as the Bank does not issue licenses but rather registers eligible PSPs.

Overall, the fee at registration application clearly satisfies three out of four principles outlined on Page 1:

- It will be **transparent** in regulations;
- It will be **simple** as a set dollar figure; and
- It will be **predictable** as a dollar figure prescribed in regulations, and any changes made to it will likely require amendments to regulations pursuant to the RPAA or be disclosed in advance through a type of communique by the Bank.

Questions for Discussion

1. Are there any considerations that have not been discussed but should be reflected in the determination of the fee at registration application?
2. Are there views on increasing or lowering the registration fee and redistributing remaining costs or savings via annual assessment fees?
3. Are there concerns with the preliminary amount for the fee at registration application? What are the main drivers of those concerns?
4. Are there concerns with a single fee at registration application? If so, what are the main drivers of those concerns and what would you recommend that the Bank consider in calibrating this fee?
5. Are there concerns with having a fee at registration application that is not adjusted very frequently (aside from inflation adjustments)? What are the main drivers of those concerns?

Fee 2 of 2: Annual Assessment Fee

The Bank's cost of supervision that has not been recouped through the sum of fees at registration application would need to be allocated through an annual assessment fee to each registered PSP (as per subsection 99(3) of the RPAA). For clarity, PSPs that have had their registration refused or revoked would **not** be assigned an assessment fee.

The Bank is exploring an approach where there are two parts to the annual assessment fee:

- Part 1 – a minimum, equal fee that is charged to all registered PSPs to reflect how the Bank would need to conduct a basic level of supervisory activities for all PSPs on an on-going basis (e.g., reviewing all PSPs' annual regulatory reports and monitor their compliance with the RPAA); and
- Part 2 – a variable fee that is charged to each registered PSP, driven by a set of quantitative metrics regarding that PSP's payment activities.

How exactly the fees associated with Parts 1 and 2 could be calculated is discussed in the following subsections.

Part 1 – Minimum Assessment Fee

A minimum assessment fee could be set in regulations in two ways:

- A dollar amount; or
- An amount determined through a formula (e.g., 15 – 25 % of total costs net of fees collected at registration application divided by the number of registered PSPs at the time of the assessment).

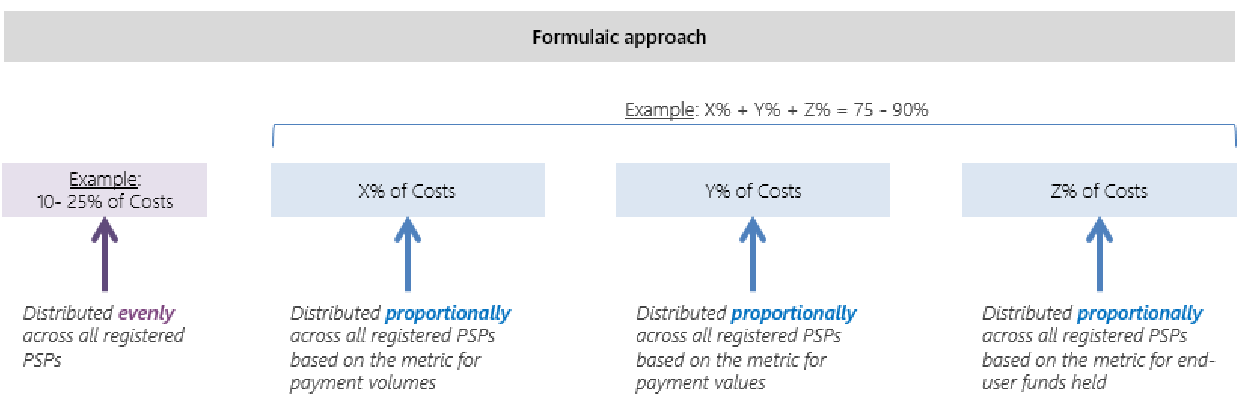
The Bank sees benefits of relying on a formula instead of a set dollar amount since this supervisory mandate is new. Prior to the coming into force of the RPAA, the Bank will not have comprehensive data on PSPs and their payment activities to determine an appropriate dollar amount for the minimum assessment fee.

Part 2 - Rest of the Assessment Fee: Using Payment Volumes and Values, End-user Funds Held

For the remainder of the assessment fee, the Bank sees benefits in using quantitative metrics provided by the PSP regarding its retail payment activities as inputs to what would drive the calculation of the remainder of a registered PSP's assessment fee.

- In particular, the Bank is exploring a formulaic approach where each registered PSPs bears a share of the cost that is directly reflective of its quantitative metrics as a proportion to their sum across all registered PSPs.

See below for an illustration.



$$\begin{aligned}\textit{Assessment fee for } PSP_i \quad = \textit{Minimum assessment fee} &+ \left(XC \times \frac{\textit{Metric for payment volumes of } PSP_i}{\textit{Metric for payment volumes of all registered PSPs}}\right)\\ &+ \left(YC \times \frac{\textit{Metric for payment values of } PSP_i}{\textit{Metric for payment values of all registered PSPs}}\right)\\ &+ \left(ZC \times \frac{\textit{Metric for end user funds held of } PSP_i}{\textit{Metric for end user funds held of all registered PSPs}}\right)\end{aligned}$$

Where C = Costs to recover (net of fees collected at registration application)

This formulaic approach meets the four principles outlined on **Page 1**.

- It will be **transparent** with the details of this approach being prescribed in regulations or as part of the Bank's bulletin on costing (see the Transparency discussion on Page 5).
- It is **simple** with the formula determining the assessment fee amount for each PSP.
- It is **predictable** since all variables required for each PSP to be able to calculate its assessment fee are either: (i) provided in the Bank's bulletin on costing, each year; or (ii) based on the retail payment activities of that the PSP would provide directly to the Bank.

  - For clarity, the only variables that would be determined by the Bank or through regulations would be the distribution of costs across the three quantitative metrics of retail payment activities – X%, Y%, and Z%. These would be provided in the Bank's bulletin on costing or prescribed in regulations.

- It is **fair** since it partly reflects where the Bank's supervisory efforts may be spent. It also accounts for undue financial burden that may be placed on entities that do not have significant scale of retail payment activities or market presence.

Transparency

The Bank considers being transparent about costs and fees as paramount. To make sure registered PSPs are informed of the components that determine their assessment fees, the Bank will issue a communique (e.g., bulletin on costing) in the early months of each calendar year, prior to the registered PSPs receiving their assessments. The communique will disclose any values or amounts that are either in the Bank's control or based on aggregation of data across all PSPs.

Questions for Discussion

6. Do RPAC participants recommend factors that should be considered when setting the values of X, Y, and Z, which would determine the proportion of costs to be assigned to each metric of retail payment activities?

    a. Is there a potential for adverse impact on the retail payments ecosystem stemming from relative values of X, Y, and Z that the Government and the Bank should be mindful of?

7. What are RPAC participants' views on setting a minimum assessment fee, and relying on a formula to do so instead of a set dollar amount?

8. Is there an alternative calculation methodology that RPAC participants recommend the Bank consider for assessment fees?

9. To make sure the metrics used are calculated the same way across all registered PSPs, the Bank could request that these metrics cover the previous calendar year for all retail payment activities provided by the registered PSP. Should these metrics be aligned with the perimeter of the RPAA instead, and have registered PSPs without a place of business in Canada report metrics that cover retail payment activities directed to end users in Canada only?

Other Considerations related to Annual Assessment Fees

The Bank would like to gather feedback on two other considerations related to annual assessment fees: (i) the use of revenue or income as an input to calculating annual assessment fees; and (ii) the use of a threshold that requires certain registered PSPs to pay the minimum assessment fee only.

Use of Revenue or Income as Input

The Bank's preliminary view is that using revenue or income as an input to calculating annual assessment fees come with two complications.

- For some registered PSPs, providing retail payment activities is not the sole focus of their business and revenue could be generated from products and services that are not associated with retail payment activities. If revenue or income will be used in calculating the annual assessment fee, there will need to be a decision on whether a registered PSP's revenue or income that is strictly from the provision of retail payment activities should be used, rather than total revenue or income.

- For PSPs that provide retail payment activities only but are foreign-domiciled, another question remains on whether the revenue or income used to calculate annual assessment fees should be limited to revenue or income from providing retail payment activities to end users in Canada only. If total revenue or income is used as input for registered PSPs that have a place of business in Canada, this means the source of revenue or income would differ across domestic and foreign-domiciled registered PSPs

Additionally, the amount of revenue or income generated by a PSP is not a factor being considered to determine how the Bank applies its risk-based supervision approach. Using revenue or income as the sole variable to calculate assessment fees would not necessarily reflect the level of effort spent on supervising a PSP, particularly for entities that do not generate much revenue or income but do have a significant market presence.

However, the Bank recognizes that some regulatory regimes use regulated entities' revenue or income as a metric to determine the annual fee paid to recover costs. As such, the Bank would like to hear stakeholders' considerations in support of relying on such a metric, and result in a simple, predictable, and fair distribution of fees.

Questions for Discussion

10. Do RPAC participants have a different perspective that supports the use of revenue or income as an input to calculating annual assessment fees?
11. If revenue or income is an input, what are RPAC participants' views on characterising this metric – e.g., inclusion of all revenue, inclusion of revenue sourced from retail payment activities only, inclusion of revenue sourced from retail payment activities provided to end users in Canada, etc.?

Use of a Threshold to Charge the Minimum Assessment Fee Only

The Bank is exploring the idea of setting a threshold and have registered PSPs falling below it pay the minimum assessment fee only. This would reduce the number of unique assessments, which could help reduce the administrative burden on the Bank's end.

However, this does imply that the rest of the registered PSPs who are assessed an additional amount beyond the minimum assessment fee amount would be bearing a greater share of the costs, raising questions on whether the allocation of fees remains fair and equitable. Furthermore, the reduction in administrative burden may not be meaningful if the Bank relies on a high level of automation for fee processing.

Questions for Discussion

12. What are RPAC participants' views on assessing a subset of registered PSPs the minimum assessment fee only because they fall below a threshold?
13. If this approach is implemented, on what metric(s) should that threshold be associated with (e.g., payment volumes, payment values, revenue, other)? Additionally, what should the Bank consider when determining that threshold?

Annex 1 – Illustrative Examples

<u>Important note</u>: all costs provided in this annex are projections only, and all fee amounts or distribution of costs are based on assumptions. Costs and fee amounts presented in this annex are for illustrative purposes only and are provided to guide the discussion on the approach to fees with stakeholders.

The Bank's actual annual cost incurred to carry out its mandate under the RPAA will depend on a number of factors that remain uncertain, including but not limited to: (i) the number of registered PSPs, (ii) the level of supervisory effort required to assess the PSPs' compliance with the requirements under the RPAA; (iii) the degree of automation possible through technology. Moreover, the allocation of fees to recover the Bank's annual cost will depend on what is ultimately prescribed in regulations pursuant to the RPAA with respect to fees, which is led by the Department of Finance Canada.

Assumptions

Based on early estimates, the Bank believes there could be approximately 2,000 PSPs in scope and up to 150 individuals at the Bank working directly on, or supporting, PSP supervision. The current estimate of the annual cost base to recover is $35 - $40 million per year, once the RPAA fully comes into force and the program is in steady state.

- It is important to note that this is an estimate based on inputs with an elevated degree of uncertainty, and will change based on further clarity regarding the number of PSPs and the level of effort required by the Bank to assess the PSPs' compliance with the requirements under the RPAA.

For the purpose of calculations provided under Example A and B below, assumptions applied are listed below.

Total projected annual cost to be recovered by the Bank through fees under the RPAA	**$40 million**
Number of registered PSPs	**2,000**

Example A

In Example A, the fee at registration application is assumed to be set at **$2,500 per applicant** (as noted on Page 2) and the proportion of annual cost to be allocated via a minimum assessment fee is assumed to be **20%**. Note that it is assumed that all applicants that register with the Bank remain registered, and the assessment fees are assigned the same year those applicants register with the Bank.

Fee breakdown	Total Fees Collected or Costs to be Allocated under Example A	Fee per applicant or PSP under Example A
Registration Application Fee	**$5 million** Sum of registration application fees collected assuming 2000 PSPs ($2,500 x 2000)	**$2,500 per applicant**
Assessment Fee Part 1 of 2 (the minimum assessment fee)	**$7 million** Total residual cost to be allocated via minimum assessment fees, less the sum of registration application fees collected ($35 million x 20%)	**$3,500 per PSP** ($7 million / 2000)

Assessment Fee Part 2 of 2 (fee based on retail payment activity metrics)	**$28 million** Total residual cost to be allocated via assessment fee based on retail payment activity metrics ($35 million - $7 million)	**$14,000 per PSP** Assumes costs are distributed evenly across all registered PSPs as opposed to proportionally based on their market share of retail payment activities ($28 million / 2000)

Again, without accounting for a registered PSP's market share of retail payment activities and assuming that fees will be allocated evenly across all registered PSPs, a registered PSP could pay a total of $20,000 in the same year it registered with the Bank.

If the assessment fee approach is designed to reflect a registered PSP's market share of retail payment activities, and the assumptions made in this example hold true, a new PSP entering the retail payments ecosystem could be charged closer to $6,000 (i.e., the annual minimum assessment fee of $3,500 under Example A, alongside a registration application fee of $2,500).

Example B

In Example B, the fee at registration application is assumed to be lowered to **$1,000 per applicant** to reduce a financial barrier to entry for firms to become a registered PSP. As noted on Page 2, in this example a larger proportion of annual costs would need to be allocated via annual assessment fees than in Example A.

The proportion of annual costs to be allocated via minimum assessment fees is also assumed to be lowered to **10%** to reduce the annual financial burden on entities with a very small market share of retail payment activities. This implies a larger proportion of annual costs than in Example A would need to be allocated based on retail payment activity metrics, if the preliminary assessment fee approach presented in this note is implemented.

Similar to Example A, it is assumed that all applicant that register with the Bank remain registered, and the assessment fees are assigned the same year those applicants register with the Bank.

Fee breakdown	Total Fees Collected or Costs to be Allocated under Example B	Fee per applicant or PSP under Example B
Registration Application Fee	**$2 million** Sum of registration application fees collected assuming 2000 PSPs ($1,000 x 2000)	**$1,000 per applicant**
Assessment Fee Part 1 of 2 (the minimum assessment fee)	**$3.8 million** Total residual cost to be allocated via minimum assessment fees, less the sum of registration application fees collected ($38 million x 10%)	**$1,900 per PSP** ($3.8 million / 2000)
Assessment Fee Part 2 of 2 (fee based on retail payment activity metrics)	**$34.2 million**	**$17,100 per PSP**

	Total residual cost to be allocated via assessment fee based on retail payment activity metrics ($38 million - $3.8 million)	Assumes costs are distributed evenly across all registered PSPs as opposed to proportionally based on their market share of retail payment activities ($34.2 million / 2000)

Again, the assessment fee breakdown per registered PSP shown above does not account for a registered PSP's market share of retail payment activities and assumes that fees will be allocated evenly across all registered PSPs.

If the assessment fee approach is designed to reflect a registered PSP's market share of retail payment activities, and the assumptions made in this example hold true, a new PSP entering the retail payments ecosystem could be charged closer to $2,900 (i.e., the annual minimum assessment fee of $1,900 under Example B, alongside a registration application fee of $1,000).