Access to Bank of Canada Settlement Accounts for the Real-Time Rail

This paper sets out the Bank of Canada’s (the Bank) policy for providing payment system settlement accounts (referred to as “settlement accounts”) to Direct Settlement Participants (DSPs) in the Real-Time Rail (RTR) which is operated by Payments Canada. These requirements replace the requirements related to RTR which were communicated in the Bank’s February 26, 2019 paper Access to Bank of Canada Settlement Accounts.

The provision of a Bank of Canada RTR settlement account provides benefits to the payments system overall, allowing for real-time settlement on the books of the Bank. This promotes safety, efficiency, competition and innovation, but it may also expose the Bank, Payments Canada and/or other participants to risk. The requirements set out here are designed to balance these considerations.

This policy establishes explicit participation, legal, regulatory, business need, financial, and Know Your Client requirements that must be met by the applicant for the Bank to consider granting an RTR settlement account. Certain applicants will also be asked to provide evidence that they can secure sufficient payment capacity to settle RTR payments.

The Bank will grant two types of settlement accounts: unrestricted accounts which will allow the account holder to settle on behalf of itself and Indirect Settlement Participants (ISPs), and restricted accounts which will allow the account holder to settle only on behalf of itself. More stringent requirements will be applied to unrestricted account holders as articulated in this policy.

The Bank reserves the right to request additional information beyond what is outlined in this policy to assess applicants against the requirements described here, and in all cases reserves discretion to determine whether to provide a settlement account. Once a settlement account has been provided, compliance against the eligibility requirements will be monitored on an ongoing basis and the Bank may require settlement account holders to periodically provide information to facilitate this assessment.

There will be a streamlined RTR settlement account application assessment approach for Lynx settlement account holders, as they have already been formally evaluated by the Bank and demonstrated their ability to meet the same (or more stringent) requirements. Please see the table at the end of this note for the streamlined set of requirements that will be applied to these institutions.1

Settlement accounts are intended only to facilitate RTR payment activity. Therefore, the provision of such accounts is distinct from other central bank accounts and lending policies that are made available to some market participants for other policy reasons.

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1 There will also be a streamlined RTR settlement account application assessment approach for those who successfully apply for an ACSS settlement account. For more information, please contact the Bank.
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**Settlement account structure**

Accounts in the RTR will be deemed accounts on the books of the Bank, which will be operated in the RTR by Payments Canada on behalf of the Bank. The Bank will consider DSPs’ Payment Capacity Accounts as their settlement accounts.²

The High-Availability Banking System (HABS) will represent the funding channel between Lynx and the settlement accounts in RTR. The Bank will maintain an RTR suspense account within HABS where the conversion from Lynx liquidity to RTR liquidity will occur.³ The Bank will not maintain individual RTR DSP account balances in HABS. This suspense account should not be interpreted as a pooled deposit account.⁴

This approach will centralize the management of RTR funding for RTR DSPs under a single system. This account structure ensures that RTR DSPs have a live balance from the RTR as a single source of truth. It also ensures a simple funding/defunding process leveraging the RTR risk controls (e.g., the Payment Capacity of the RTR DSP).

The prefunding of RTR settlement accounts will be done via Lynx payments in the name of the applicable RTR DSP. RTR DSPs who are also Lynx Direct Participants will fund their own RTR settlement accounts. Any applicant who is not a Lynx Direct Participant will need to arrange for a lead Lynx Direct Participant to act as its banker to fund its RTR settlement account. While RTR settlement account applicants are not required to have arrangements with a banker already in place before initiating their application, arrangements must be in place before the RTR settlement account becomes operational.⁵

**Settlement account types**

Applicants will be asked to indicate whether they are applying for an unrestricted settlement account or a restricted settlement account. The Bank will apply higher requirements for applicants of an unrestricted settlement account.

- **An unrestricted settlement account** will permit the account holder to settle on behalf of itself and act as a Settlement Agent (SA) for ISPs in RTR;
- **A restricted settlement account** will permit the account holder to settle only on its own behalf, i.e. it is not permitted to act as a SA in RTR.

If a restricted settlement account holder decides to apply for an unrestricted settlement account, it should inform the Bank so the Bank can evaluate whether it meets the higher requirements. Applicants must not commence settling on behalf of ISPs until they receive notice from the Bank that they have become an unrestricted settlement account holder.

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² Henceforth in this note, RTR Payment Capacity Accounts are referred to as RTR settlement accounts.
³ Since the Bank of Canada is the only institution which grants liquidity in Lynx (via advances), it controls the flow of liquidity between Lynx and RTR. The conversion of liquidity associated with this flow is performed through HABS via the RTR suspense account.
⁴ This should be true both legally and from an accounting perspective.
⁵ RTR DSPs will be able to update these arrangements as required.
The Bank will conduct periodic assessments to determine whether each settlement account holder continues to meet the requirements for settlement account access. The Bank also reserves the right to (i) revoke the unrestricted status of a participant’s settlement account; or (ii) remove the account holder’s settlement account access entirely, if necessary.\(^6\)

**Settlement account application requirements**

This section outlines the RTR settlement account application requirements with guidance on whether (i) the given requirement differs or is the same for restricted and unrestricted settlement accounts; and whether (ii) the given requirement is already met by existing Lynx settlement account holders.

**Payments Canada associated requirements**

Applicants for an RTR settlement account must be members of Payments Canada and demonstrate they meet Payments Canada’s requirements to participate directly in the RTR.

\begin{itemize}
  \item This requirement is the same for both restricted and unrestricted settlement accounts.
  \item The requirement to be a Payments Canada member is already met by Lynx settlement account holders.
  \item The need for applicants to demonstrate they meet Payments Canada’s requirements to participate directly in the RTR must be met by Lynx settlement account holders.
\end{itemize}

**Legal requirement**

Successful applicants will have to enter into the Bank’s agreement governing the RTR settlement account, which sets out the rights and duties of both the Bank and the account holder with respect to maintaining and operating a settlement account on an ongoing basis.

\begin{itemize}
  \item This requirement is the same for both restricted and unrestricted settlement accounts.
  \item This requirement must be met by Lynx settlement account holders.
\end{itemize}

**Regulatory requirement**

**Baseline requirement**

Applicants for a settlement account must be:

\begin{itemize}
  \item Financial institutions that are federally or provincially regulated;\(^7\) or
  \item Non-bank payment service providers registered and regulated under the Federal retail payments oversight regime, the Retail Payments Oversight Framework (RPOF).\(^8\)
\end{itemize}

\begin{itemize}
  \item This requirement is the same for both restricted and unrestricted settlement account.
  \item This requirement is already met by Lynx settlement account holders.
\end{itemize}

\(^6\) The Bank would give the account holder and Payments Canada sufficient notice of any forthcoming restriction or removal in order to allow any ISPs settling through the SA to find an alternative SA and/or for the account holder to find a SA.

\(^7\) Due to the different nature of their regulation and supervision, the Bank will consider access to securities dealers, money market mutual funds, and insurance companies (including those regulated by OSFI) on a case-by-case basis based on expression of interest.

\(^8\) These entities will be eligible to apply for a settlement account once the legislative and regulatory provisions related to registration, operational risk management, and end user fund safeguarding expectations under the Federal retail payments oversight regime are in force.
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**Business need requirement**
Applicants will be required to explain their business need and plans for an RTR settlement account. The business need and plans must satisfy the Bank that the institution has an applicable payments-based business model and will be using the account solely for settlement of RTR payment activity.

*This requirement is the same for both restricted and unrestricted settlement accounts. This requirement must be met by Lynx settlement account holders.*

**Financial health requirement**
Applicants will be required to provide information that will allow the Bank to conduct a high-level assessment of their financial viability. This requirement is intended to manage (but not eliminate) the risk that a participant could fail and cause operational strain to the system.

**Baseline requirement**
A questionnaire will be sent to all applicants, with information requirements differing by institution type that would include:

- Financial institutions: information allowing the Bank to assess whether the applicant is expected to continue to meet various financial regulatory requirements as set out by their prudential regulator (e.g., related to capitalization, funding and liquidity standards).
- Non-bank PSPs: audited annual financial statements from the past three years (or a shorter period if unavailable due to being a new entity), and its latest quarterly statements to allow the Bank to assess their going concern status.

In the event that the Bank’s high-level assessment revealed weaknesses that could impact an applicant’s financial viability, the Bank may decide to (i) turn down the settlement account request (implying the RTR participant would have to settle indirectly); or (ii) if the Bank deems the overall benefits of granting the account outweighs the risks, use its discretion to still grant it with appropriate risk mitigation measures. Such measures would include providing access to a restricted account only.

**Additional requirements for an unrestricted account**
In the event of a SA failure, the SA’s ISPs would need to migrate to an alternate SA before they can resume their system activity. Given this additional operational consideration, more stringent financial viability expectations will be applied to SAs, although the high-level assessment will generally be based on the same information as considered under the baseline requirement.

*This requirement differs between restricted and unrestricted settlement accounts. This requirement is already met by Lynx settlement account holders.*
Means to secure sufficient payment capacity

Baseline requirement

The Bank expects DSPs to always have sufficient payment capacity to settle their RTR payments. The Bank will ask that DSP applicants provide the Bank with estimates of their peak and average daily payment flows and describe their plans to ensure they maintain adequate payment capacity to allow all of their RTR payments to settle.

Additional requirements for an unrestricted account

There would be negative implications if a SA ran out of payment capacity since both its and its ISP customers’ payments would be rejected until such time it could secure additional payment capacity. Therefore, the Bank will apply higher expectations for settlement agents to demonstrate that they will be able to secure ample payment capacity both for their own activity and the ISPs on whose behalf they settle. The Bank will also expect that SAs will be large relative to their ISP customers so they can easily obtain and replenish payment capacity to cover their own and their ISPs customers’ needs.

Applicants for an unrestricted settlement account will be asked to provide information on:

- Their peak and average daily payment flows
- The number and type of ISPs they intend to settle on behalf of
- Expected peak and average daily flows of ISPs they intend to settle on behalf of
- The sum of expected net debit caps they intend to apply to their ISP customers
- Planned mechanisms to obtain payment capacity

This requirement differs between restricted and unrestricted settlement accounts. This requirement is already met by Lynx settlement account holders.

Know Your Client requirement

Applicants must satisfy the Bank’s Know Your Client (“KYC”) requirement which includes collection of basic due diligence information (e.g. applicant name, head office address etc.) and information detailing the directors and beneficial ownership of the applicant.

Applicants will also be required to attest to the presence of a financial crimes program and confirm controls such as ongoing monitoring of its business relationships. This supports the Bank’s responsibility to perform due diligence on those who will be settling payments via settlement accounts on the books of the Bank.

This requirement is the same for both restricted and unrestricted settlement accounts. This requirement is already met by Lynx settlement account holders.
In 2019, the Bank conducted a formal evaluation of all applicants for Lynx settlement accounts. It is not necessary for institutions who have undergone a formal Lynx settlement account application process to provide the full set of information specified in this policy. Such applicants will only be required to provide information in the categories marked with a check mark below.

<table>
<thead>
<tr>
<th>RTR settlement account application requirement</th>
<th>Applicable to Lynx settlement account holders</th>
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<tbody>
<tr>
<td>1. Demonstrate that Payments Canada’s requirements to participate directly in the RTR have been met</td>
<td>✓</td>
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<tr>
<td>2. Enter into an RTR settlement account agreement with the Bank</td>
<td>✓</td>
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<tr>
<td>3. Demonstrate an applicable payments-based business model</td>
<td>✓</td>
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<tr>
<td>4. Be a member of Payments Canada</td>
<td>n/a</td>
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<td>5. Provide information to allow the Bank to evaluate compliance with the Bank’s Know Your Client requirements</td>
<td>n/a</td>
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<td>6. Provide information on regulatory status</td>
<td>n/a</td>
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<td>7. Demonstrate means to sufficiently fund Payment Capacity Account</td>
<td>n/a</td>
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<tr>
<td>8. Demonstrate adherence to the Bank’s financial health requirement</td>
<td>n/a</td>
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