



Introduction of a Retail Payments Supervision Framework in Canada

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Anatol Monid:

Hi everyone. Welcome to TC Podcasts on-the-go. I'm Anatol Monid, a Senior Director with the Toronto Centre. Today, I have the pleasure of speaking with Mr. Ron Morrow. This interview was inspired by our January 2023 Toronto Centre Note and accompanying podcast, examining the regulation of supervision and retail payments, and with the news of Ron's appointment as Executive Director - Supervision at the Bank of Canada, effective January 3rd, 2023. In this role, Ron is responsible for supervision of retail payments service providers and the oversight of financial market infrastructures (FMIs). I will let Ron better introduce himself and talk about the Bank of Canada and the payment supervision in a moment. His profile is also available at our website. Our conversation will focus on the introduction of retail payment supervision framework. In Canada, the safe and efficient movement of funds is essential to the health and strength of any national economy.

Evolving technologies permit retail payment activities in new and increasingly complex ways by a larger variety of payment service providers such as card networks, payment processors, and digital wallets, commonly referred to as non-bank players, including FinTech and Big Tech. A lack of requirements and supervision increases risks to consumers and businesses such as the risk of financial loss and instances of business insolvency and threats to the security of sensitive personal financial information. What can emerging market and developing economy countries learn from Canada's recent introduction of payment supervision? Welcome, Mr. Morrow, Ron, and thank you for taking the time to speak with me today.

Ron Morrow:

Thanks, Anatol. It's a pleasure to be here. Thanks very much for the invitation.

Anatol Monid:

And can you tell us a little bit about your role and the work at the Bank of Canada?

**Ron Morrow:**

Sure. My role is to oversee the bank's supervisory responsibilities. So that includes our new mandate for overseeing payment service providers as well as an existing mandate for the supervision of financial market infrastructures. So, why don't I talk to you a little bit about this new mandate.

Anatol Monid:

Thank you.

Ron Morrow:

So, this new mandate came to the bank a couple years ago. So, the Retail Payments Activities Act, or RPAA was passed in the summer of 2021, and it gives the bank responsibility for supervising payment service providers (PSPs). You've touched a little bit on who those entities are, I'll come back to that in a second, but let me say a few words about the motivation behind this mandate. Why exactly have we been tasked with it? Well, the fact of the matter is everyday millions of Canadians place their trust in PSPs whenever they tap their card on a payment terminal or make an online purchase, perhaps unbeknownst to Canadians, there's at least one and more often several payment service providers who are involved in getting the payment from the consumer to the merchant. And our job is to make sure that that trust is well placed, that Canadians can be confident that any funds they're holding with a PSP are going to be protected and that risks are being managed.

So, who are these entities? Well, you touched on them: payment processors, digital wallets, payments technology companies, etc. We have an advisory committee we set up of payment service providers, and if you look at that list, you'll see some of the household names when it comes to payments: PayPal, Western Union, visa, MasterCard, etc. But you'll probably see a whole bunch of names that you don't recognize, and that reflects the fact that there are many thousands of very small payment service providers who play a niche role in the payments ecosystem. These can be two and three person FinTech companies, so it's a pretty broad mandate in terms of the range of entities that we oversee. Our current count is that there are probably 2,500 of these companies operating within Canada. So, we've been working hard on this new mandate. We have the legislation, regulations are being finalized right now, hopefully finalized by the fall with supervisory guidance to follow, we'll start registering PSPs in 2024, and we'll start to formally supervise them in 25.

Anatol Monid:

Great. Thanks for that lay of the land and maybe we'll have an opportunity to reconnect in 2025 when all of that hard work is done. From a constitutional perspective, Canada has a complex financial services, regulatory, and supervisory structure. So, perhaps some context for our listeners, given the mandate you've described under the Retail Payments Activities Act, who else does the bank work with amongst the many other financial services supervisors and regulators as well as non-bank players?

Ron Morrow:

So you're absolutely right, Anatol. There's a wide variety of people that we engage with as we've been putting this mandate together. I mean, there are a few of very important federal partners we have been working with. Obviously, the Department of Finance as they're ultimately responsible for the legislation and the regulations that underlie this new mandate we've been given. We've been working very closely with FINTRAC (The Financial Transactions and Reports Analysis Centre of Canada), who is Canada's anti-money laundering and anti-terrorist financing organization. There there's some information sharing aspects of this new mandate between ourselves and FINTRAC, so we've been working closely with them.



We've also been reaching out internationally to our counterparts in other countries. There are a number of other jurisdictions that have some well-established supervisory regimes for payment service providers; the EU and the UK are two examples of those types of regimes. So, we've reached out to them and had some very helpful - them and others - to have some very helpful conversations. First, understanding why they've set up their regimes the way they have, but also for us to get a sense of what norms have arisen when it comes to supervising payment service providers so that we can ensure that those same norms are incorporated into our regime providing they make sense for Canada, and in almost all cases, they do.

Within Canada, as Canada is a federation and its regulation is a shared responsibility amongst the federal government and provinces across a variety of areas, we've worked very closely with the provinces to ensure that they understand what our regime is and what it isn't, and what our responsibilities are. So, we have three main responsibilities: to maintain a registry of payment service providers, to ensure that funds are adequately safeguarded, and operational risks are well managed. The regime is not at all about things like a broader array of consumer protection issues, which is an example of something that is a responsibility of provincial jurisdiction, not federal jurisdiction. So, it's a big cast of characters, but touch on wood, so far there have been some very constructive conversations with everyone along the way.

Anatol Monid:

On the non-regulatory player side, I've heard of an organization called Payments Canada. What relationship does your agency have with them?

Ron Morrow:

So, Payments Canada is an organization that was created by Parliament to run the core payments infrastructure here within Canada. So, they operate the large value payment system which functions in Canada. That allows financial institutions to move money back and forth, they operate a number of other payment systems, and are in the process of developing a real time payment system, also otherwise known as a Faster Payment System (FPS), which is something that exists in many other jurisdictions and we're just building one in Canada right now. So, our relationship with them as the supervisor for financial market infrastructures, we oversee a number of the systems that Payments Canada operates. We also will have a future relationship with them as part of our new mandate because entities that are overseen by the Bank of Canada will be eligible to participate directly in the payment system. So, non-banks, right now, it's strictly financial institutions that operate within the payments directly in the payment system in Canada. With the advent of this new regime, non-banks, so PayPal or others, would be able to apply to become direct members in the payment system, allow them to interact directly with their clients without having to go through a bank or other financial institution.

Anatol Monid:

Thanks. The scope of the regulation and supervision you described really covers the retail payment systems. So, how have you set supervisory priorities to address user safety and security and operational resilience while keeping a system efficient?

Ron Morrow:

So, as I noted, there are kind of three major legs to the regime: maintaining a registry, operation risk, and safeguarding end user funds. There's some pretty comprehensive requirements we've established through the regulations, and in terms of maintaining efficiency, one of the big things we've done is engage with the industry. So, we're many things, but we're not perfect.



We recognize that as we develop this regime, there are some things that we'll get right and some things that might need to get tweaked. So, it's been a lot of dialogue with the industry; we've set up an advisory committee, we work with industry associations and others to get their feedback on what we're doing and to ensure that it's as efficient as it can be. On the one hand, we want to ensure that end users are adequately protected. On the other hand, we don't want to overly burden the industry.

So, we have received a lot of feedback on the regulations, specifically in the area of burden payment service providers felt that there were a number of areas where the regulations were configured in a way where they weren't efficient, they were potentially overly burdensome. So, we've heard that feedback and are working with the industry or are working with our colleagues at the Department of Finance to see where those can be tweaked. In addition, in the pursuit of efficiency, we're going to be taking a risk-based approach to our supervision. What that means is the level of supervisory attention and the supervisory actions we take are really going to be guided by the risk that each PSP brings to consumers in the payments ecosystem. If, for example, you are a large multinational, multi-billion-dollar payment service provider, you probably already have a very thick board-approved risk binder that outlines all the risks you face as an organization and all the things you're doing to manage them. That's great; that will go a long way towards demonstrating your compliance with the regime.

If on the other hand you are a small PSP, maybe a founder and a couple of employees, you may not even have a board of directors, never mind a board-approved risk binder. Really all we're going to be looking to from them is they're going to have to have a little framework in place, write down what they see as the major risks they face and how they're managing them. So, in that way, we're going to try to be as efficient as possible and try not to ensure that we're not overly burdening PSPs. It's not a one size fits all approach. It's one in which we want to tailor people's ability to demonstrate compliance based on the nature of their nature of their organization.

Anatol Monid:

So, it sounds like you indicated earlier that there are about 2,500 entities that you're going to be supervising, so taking a risk-based approach is prudent and it sounds like you're considering proportionality in your supervision as well.

Ron Morrow:

Absolutely.

Anatol Monid:

Great. So, while financial inclusion in Canada is quite high, moving on to something else, have you considered if there are any barriers to access and inclusion to the payment system that some Canadians may face?

Ron Morrow:

Absolutely. I mean, Canada's made some pretty good strides when it comes to financial inclusion, but it's really important for us not to be complacent. New FinTech companies and new innovations in this payment space can be effective at improving financial inclusion and bringing people into the FIN financial system more broadly. So, as that's happening, we want to make sure our regime doesn't pose any undue barriers to that innovation. We don't want to inhibit further progress that can be made in areas like financial inclusion. But, on the other hand, this is all about ensuring that there's, if I can coin the term responsible innovation, that's kind of what we're focused on.



Making sure that while these innovations and new apps and new technologies make their way to individuals within Canada, that it's done in a way that adequately protects the interests of end users in a manner that's consistent with our mandate.

Anatol Monid:

So, I like that term responsible innovation, and it dovetails nicely with my next question: I read that the Bank of Canada says that consumers and businesses benefit from innovation in a payment system when the right precautions are in place. So, does the Bank of Canada have an approach to innovation? It sounds like you have an approach to innovation, but do you have an innovation hub that can help with different ideations to take place or a regulatory sandbox where startups and FinTechs can get support or guidance before going live within the system?

Ron Morrow:

So, I wouldn't say we have a sandbox per se, in the classic sense; what we do have is a lot of ongoing engagement with the industry. We have a wealth of information that we're providing to PSPs, we have a lot of engagement at conferences and gathering of FinTechs as we A - make them aware of the mandate, but B - make them aware of what their responsibilities are going to be under this mandate. So, it doesn't involve a lot of consultation with the industry. As I said, we're very open to the idea that we haven't gotten things perfect from the outset. We need to be able responsive to thoughts from FinTechs in terms of the level of burden of our regime and whether or not there's a more efficient way for us to be doing it. It is a kind of registration regime. There's a single bar and all PSPs need to meet a minimum standard, whether they're large or small. But we will be, as I noted earlier, kind of taking a risk-based approach to ensure that they try to manage the level of compliance burden on smaller players.

Anatol Monid:

Okay, thanks. Maybe we can turn from payment players to your work under the Payment Clearing and Settlement Act, and I understand that the bank is responsible for the oversight of financial market infrastructures, continuing, that FMIs play a significant role in enhancing financial stability by enabling consumers and firms to safely and efficiently purchase goods and services, make financial investments, and transfer funds. So, how do your supervisory principles and practices differ from payment systems, central counterparties, and securities settlement systems?

Ron Morrow:

That's a great question. So, FMIs are fundamentally different than payment service providers. That's because they're really at the core of a financial system. So, what are FMIs? So, they're large value payment systems that allow people to institutions to move money back and forth, and ultimately their customers as well. Their central securities and repositories and security settlement systems allow for the trading of bonds and equities within a financial system. So, they're super critical; the financial system doesn't function unless these systems are up and functioning. If there's a problem there, this is a problem for the financial system and for the economy as a whole. So, as a result, there's a pretty high bar, a pretty high standard that FMIs are held to ensure that they're robust to a broad range of potential risks. Our approach to supervision of FMIs really leverages off of something called the principles for financial market infrastructures, which were developed by the Committee on Payments and Marketing Infrastructures, which is part of the BIS.



So, they developed 24 principles to guide the supervision of FMIs, and we've adopted those, and they range from core underlying elements. Is there a strong legal basis both for the FMI and for the supervision? Is there strong governance that focuses on the public interest aspect of the FMI, within the FMIs themselves, but it also gets at the more typical types of risks that you'd be concerned with: are credit risks adequately controlled? Our liquidity risks adequately managed? Are operational risks dealt with in a reasonable way? So, while there's some overlap with what we do here and with what we're doing with payment service providers, it is generally I would say a much higher bar and a much higher level of resilience that we're looking for in FMIs. PSPs, on the other hand, it's a much narrower scope of oversight. Really, it's only about managing some risks or making sure that some risks are managed on operational risk. We don't focus on credit or liquidity risk when it comes to overseeing payment service providers explicitly, and that's really how the two approaches differ.

Anatol Monid:

So, it's great to hear that Canada has adopted international standards. That's good to hear, and you talked about potential risks, and maybe I'll pop a question here Ron, do you treat cyber risk differently when you consider financial market infrastructure? Anything you'd like to share with the audience on that?

Ron Morrow:

Sure. So, when it comes to FMIs, we're really looking to make sure that they're extremely robust to a broad array of cyber risks. We want to make sure that there's adequate safeguards and backups in place. So, in the event there's a cyber-attack, there's a resilient second site or second set of systems that they can activate. So, because our focus is really on making sure that those systems are up and running, every day without fail, our oversight of PSPs is going to be at a much lower level of, there'll be a lower bar of focus there. We'll want to make sure that they have a plan for dealing for addressing cybersecurity. They should have some sort of business continuity planning. With FMIs, the plan has to ensure that they're up and running within two hours of a disruption. For PSPs, we're not going to have a minimum standard, they just have to have a plan and be able to execute on it. So, there are similarities, but the biggest difference between the two is focus on a much, much, much higher level of resilience for FMIs.

Anatol Monid:

Great. Thanks for that. So, you've been generous with your time and very forthright with your answers. As we close, given your experience, what advice do you have for other central bankers, regulators, and supervisors in preparing to supervise a jurisdiction's payment system?

Ron Morrow:

I think the advice I'd have is this is a fast-moving area. The payment industry has changed a lot over the past four or five years as technological innovation has taken place. And it's really important for supervisors to try to stay on top of the latest advancements in technology, security, and regulations to understand the extent to which those advancements can pose potential risks that may need to be addressed through supervision. But, it's also important that supervisors not go off and try to do this on their own. It's really important that they collaborate and work closely with the industry and with stakeholders and be humble about it. I mean, we were very humble going into this mandate. We know a lot about payments, but we don't know it all, and we've learned a lot in engaging with the industry and understanding how they work. I think it's also very important, finally, for supervisors to be very transparent in their interactions with the industry.

So, as we've engaged and sought feedback, we've been very transparent in terms of publishing the documents we've consulted on, publishing summaries of what occurred in those discussions, because not everyone can be in the room at any given time. So, it's our way of trying to make sure the industry as a whole can see what our approach is, see what our understanding is of them, and see how we're evolving and give them the opportunity to provide us with additional information in the event they think there's something we've missed.

Anatol Monid:

So, that's sound advice from an expert, so thank you Ron. Any last words?

Ron Morrow:

Well, what I will say is this has been a very exciting time for me, personally and professionally. It's not very often a central bank gets a new mandate, and it's not very often you get a plank sheet of paper to build that new mandate. So, I've learned a lot. It's been very rewarding to build this framework and we're really, really looking forward to continuing to work with the industry, get this thing up and running, start registering PSPs next year and then move on to our new day-to-day life of supervising them.

Anatol Monid:

Well. We'll be watching your work and progress and cheering you on. So, thank you so much for your time. Toronto Centre has developed and delivered programs related to payment systems and financial inclusion that may assist your authority in supporting implementation of payment systems supervision. We're happy to discuss an opportunity to develop such a program for your jurisdiction, authority, or agency. We recently launched a program on Deposit Insurance for Supervisors, so make sure you sign up for our newsletters and alerts to see what else is in store. Toronto Centre has trained more than 20,000 supervisors since its founding in 1998, and this work is generously supported by Global Affairs Canada, the Swedish International Development and Cooperation Agency (SIDA), and the International Monetary Fund (IMF) and our other founders. I'm here today in Toronto Canada, speaking with Mr. Ron Morrow, Executive Director - Supervision, Bank of Canada, and you've been listening to a Toronto Center podcast on-the-go. Thanks for joining us.