PAYTECHS OF CANADA

Response to Payments Canada's Request for Feedback

RTR Consultation Document

(October 30, 2020)

Introduction:

On behalf of the PayTechs of Canada Association, I wish to extend my appreciation for the opportunity to participate in the policy review of the proposed Real Time Rail "RTR". At this time, I would like to submit the following comments for your consideration, in response to the September 2020 paper, "Canada's New Real Time Payments System Policy Framework: RTR Consultation Document".

As you are aware, PayTechs of Canada was established in the spring of 2019 with the primary purpose of establishing a unified voice to represent the rapidly emerging Paytech sector of our economy. Across Canada today, there are some 1,000 paytech firms in existence, developing and implementing innovative payment-related financial services for the benefit of millions of Canadians and Canadian business.

PayTechs of Canada, as a not-for-profit association, provides a harmonized voice for Canadian paytech firms working to improve the payments system and furthers the opportunities to provide a value-add for the benefit of all Canadians, businesses and government, all of whom rely on the payments system daily. As seen in many international jurisdictions, the profile and prominence of paytechs continues to grow and their impacts are being widely recognized and embraced.

Canada is scheduled to launch the new Real Time Payments Rail "RTR" in 2022. Under the management of Payments Canada and supported by Interac, this new national "instant" payment's system has the potential to revolutionize this sector and facilitate the introduction of payment and payment-related innovations. If done correctly, the RTR could effectively reduce/eliminate most of the frictions or inefficiencies in the current payment's marketplace. Not only will the RTR contribute to the efficiency of the system, it can foster and encourage greater competition and the business opportunities for payments service providers; further contributing to the attainment of the public policy objectives for the payments system. The recent experiences in the UK, Australia and across Europe are a clear testament to the potential benefits that can accrue from these emerging infrastructures.

For paytech firms, access to the national payments system is not only critical to their success but serves as a catalyst for innovation, bringing about new products, services and processes into the payments ecosystem that reduce many of the embedded frictions. We understand and appreciate that access to the payments system is set out in federal legislation, and changes to which will require more consideration and effort to have amended. That said, we are pleased to learn that the RTR has been designed to easily accommodate future enhancements in terms of service offerings and new participants, whether as agents of existing members, service providers or as a class of new member.

In considering our response, PayTechs of Canada reflected on what we believe are the necessary underlying guiding principles for the payments system. In December 2017, Payments Canada released its "Modernization Target State" report and in which identified 6 guiding principles for the project, and included:

1. Ensure Safety and Reliability: Minimize the probability of operational events occurring and proactively work with partners to mitigate impact while meeting or exceeding all regulatory requirements

2. Deliver Quickly: Deliver as quickly as possible, with short term quick wins where sensible, to deliver benefits to end users and other stakeholders

3. Deliver Full Scope: Ensure delivery of the full roadmap scope to the extent possible as set out in 2016 to meet the expectations of end users and other stakeholders

4. Enable Innovation and Interoperability: Create an environment which supports and promotes innovation and interoperability

5. Build for the Long Term: Invest in initiatives that deliver long-term benefits and efficiency for the payment's ecosystem

6. Minimize Regrettable Spend: Manage Payments Canada, member and stakeholder resources effectively, prudently, and transparently, ensuring any regrettable spend is minimized.

Although possibly inferred, we believe there are additional principles that should be called out specifically and are, in our view, critical to the success of the project in delivering real value to Canadians and Canadian businesses, and include:

A. Efficiency – This principle should be viewed as two separate parts: market efficiency and system efficiency (technological), both of which are important. Points 4 and 6 above tend to adequately address system efficiency but no reference is provided to the development and implementation of a nationally critical payments system that delivers real market efficiency. Competition is a key component of efficiency, both in terms of i) intra-network competition (e.g., in facilitating competitive access to the system and the expedited rollout of new overlay services) and ii) inter-network competition (i.e., in terms of product innovations and pricing). The effect of a healthy competitive marketplace is that it bestows significant, tangible benefits to all system users (i.e., consumers, business and other network participants). The basic principle is to ensure that the proper incentives exist for attracting new members, at competitive prices and comparable service level to afford them the functionality to aggressively compete with the incumbents for any or all services for which the network supports. **Principle: The system should be efficient and effective in meeting the requirements of its participants and the markets it serves, with a particular consideration for the interests of users.**

B. Foster competition – The networked payments environment should avoid the introduction of any impediments that would otherwise hinder the development or introduction of new payment-related services in the market. To this end, the introduction of payment overlay services/competitive services requires clarity, transparency and independence in the decision-making to support the new service. **Principle: Eliminate to greatest extent possible, all unnecessary barriers to entry/participation that distort competitive outcomes.**

C. Access: System access should be risk-based with supportable, objective criteria. Given the continued dependency on incumbents, proper measures/incentives should be introduced in an effort to mitigate the conflict of interest that exists for incumbents to sponsor and/or provide technical connections to the system for new entrants who are otherwise competitors in the financial services market. **Principle: All eligible organizations must be presented with a comparable set of options for connecting to Payments Canada systems.**

Further to Section 7 of your report, "RTR Consultation Discussion Questions", I wish to submit the following feedback for your consideration:

1. Will the RTR design and policy framework as described in this document, support regulators' stated policy objectives to foster innovation and competition?

No. As in most payments systems, there is a clear competitive tension/conflict of interest that exists between the large incumbents and the newer or smaller market entrants. The result of smaller participants having to rely on incumbents for access, poses significant agency risk to the new and smaller entrant. Competition and the benefits from competition flourish when there is truly a contestable market; bringing about reduced prices, enhanced service levels and the introduction of new products and services.

The proposed framework, as designed, does little to promote competition between the current participants, nor address the financial or operational burdens associated with *agency risk*. Canada's largest financial institutions (i.e., based on payment volumes), are also Canada's largest direct clearers in the retail payments system. Collectively, this group of eight institutions control/process over 90% of Canada's payment volume. By any measure of concentration, this is significant. Historically, Canada's financial/payments services market has been characterized as an oligopolistic market effectively controlled by a small group of very large financial institutions. The lack of a competitive marketplace has meant that Canadians have been generally underserved in the financial services market, by comparison with their international counterparts.

What is increasingly troubling is the level of uncertainty in the passage of the Retail Payments Oversight Framework and further efforts to expand access to the payments system and introduce effective competition to the large traditional incumbents. Even if RPOF, which imposes conduct regulation on payment service providers, is passed, there are no guarantees that new access/participation authorities will subsequently be granted to these service providers. The result of further delays will only exacerbate the current issues of concern.

More specifically, the introduction of innovations either to the payments-system/infrastructure itself or in terms of the range of products and services available on a near-ubiquitous basis to Canadians, is well below that seen in these other countries. The high entry barriers have the effect of muting innovative options and forcing users of the payments system to leverage traditional payments processes, many of which are wrought with frictions/inefficiencies. There is an immediate need to consider and introduce a payments system access to better accommodate those entities reflected in the scope of the RPOF.

Competition should not be measured simply by the number of participants but their ability to freely operate and compete within that market. Since Canada's financial services marketplace is highly regulated, the affects of competition are already somewhat muted. In instances where there is also a restricted supply of a good or service, high entry barriers, a small number of dominant incumbents and firms who act collectively in the development and supply of a product or service, it is necessary that specific and intentional actions be undertaken by regulators and network operators to ensure competition, to the extent possible, is able to flourish. The rules of access/participation must be carefully considered to ensure competition is safeguarded.

Although, the current policy framework only contemplates participation by those currently eligible for membership in Payments Canada, considerations for a broader range of participant are now underway. In this case, it appears that insufficient consideration has been given to creating the right incentives to attract new entrants into the payments system and allow them to effectively access the system and compete on a level playing field. There is an opportunity at present for Payments Canada to clearly set forth a policy intention to admit a greater range of players and foreshadow the needed change.

The greatest reservation to the proposed policy direction is that most, if any of the largest incumbents (i.e., who maintain the largest cost advantage) are likely to erect significant hurdles that would otherwise deny access to the system. Based on the industry feedback thus far, the large incumbents are expected to refuse to offer sponsorship or connection services to the small or new entrants, make the conditions for access far too onerous, or unlikely to make it available at a reasonably competitive price. This denial of access will have the effect of maintaining the status quo, eliminating the competitive threat from new entrants and prevent or lessen competition in Canada.

As noted in your report*, "the RTR policies have been reviewed by the Bank of Canada and Department of Finance to ensure the RTR promotes fair and open access, enables competition and innovation, fosters fair and transparent pricing, implements appropriate risk controls and considers end-user interests"*. For the last several years, the Competition Bureau, Canada's leading experts in the field of competition analysis have been actively reviewing the financial services sector. It may be advisable to engage these experts/competition advocates in the suggested approach and receive/consider their feedback. For example, it appears that for access to the RTR Exchange function, participants will be required to rely on Interac as the Connection Service Provider to the RTR. This requirement creates a clear tension between payment service providers and the current group of incumbents as the Interac service is effectively bank-owned.

Since the early days of banking in Canada, Canada's payments system has been characterized as being highly vertically integrated. The degree to which a common set of owners own or control the various inputs and distribution of a particular good or service can be problematic, both in terms of reduced flexibility and erecting further barriers to entry/participation. Steps can and should be taken now to stem the potential downside impacts in the RTR and future services that come to depend on this payments system.

2. Will the proposed RTR design and policy framework support broad participation across the Canadian payments ecosystem?

No. As set out above, the competitive tension that exists between the large incumbents and smaller financial institutions or paytech firms is completely counter to the notion that in an industry where competitive forces are weak, specific and targeted actions/efforts must be taken to enhance competition that will result in increased welfare to users of the payments system.

The policy framework contemplates the addition on new possible institutions for inclusion in Payments Canada and the RTR. However, the anticipated delays before the new oversight framework will be in force and possible access/membership amendments to the Canadian Payments Act are considered, will have the affect of maintaining the status quo, essentially restricted to regulated financial institutions.

Growth in the financial services sector is largely being driven by the efforts and innovations brought about by emerging Fintech/Paytech firms. Unless provided the opportunity to directly participate in the payments system, the competitive threat from this growing sector will be marginalized as payment service providers' only access to the payments system is through an agency arrangement with a single financial institution. The network benefits from ubiquitous access will be lost.

3. Does the proposed RTR design and policy framework create attractive opportunities for providers of competitive services? Does the framework enable compelling payment options for Canadian consumers, businesses and corporations?

This is yet to be determined. Overlay services or competitive services are payment schemes, products, services or a capability that is provided to an RTR Participant (currently Payments Canada members-only) where the RTR Participant remains liable to the actions of the competitive service. As with the question of access, a tension will undoubtably exist between the third-party service provider and the incumbents.

Competition, true competition, requires markets to be contestable, meaning incumbents and new entrants are able to share in technology/infrastructure and the ease of entry/exit exhibits a discipline of prices. Since the structure, process and pricing to introduce competitive services on the RTR is unclear, it does not provide comfort that the framework will undoubtedly "**enable compelling payment options for Canadian consumers, businesses and corporations".**

4. Will the proposed policies in any way adversely impact the potential expansion of Payments Canada membership?

Yes. This policy framework embraces the current legal framework and provides little room to interpret a strong desire of the organization to support a much broader membership base. Had this question been put in the positive "Will the proposed policies in any way positively impact the potential expansion of Payments Canada membership" that answer would be a "no". Since Payments Canada has the authority to issue statements of principle and/or policy statements, it is recommended that Payments Canada make a clear pronouncement on the need to expand access to the payments system. As the pre-eminent leaders in payments policy, Payments Canada's opinions can fuel change that benefits the broader ecosystem and the Canadian economy.

For new market participants (i.e., PayTechs), there needs to be an obvious and tangible benefit to that organization to access and participate in the RTR. This means that not only are access options available, but these options present a viable business opportunity for emerging players to effectively compete with the current incumbents, as an equal partner in the payments system.

At this time, there are many unanswered questions about the access arrangements beyond the current list of eligible members; the development and implementation of competitive services; and how might the delays likely to be experienced in i) RPOF implementation and ii) CP Act amendments (membership requirements) impact the broader ecosystem participants and what contingency plans are under consideration. Without these changes, membership is unlikely to expand by any measurable amount and the benefits from competition will be muted.

5. Are there any additional RTR considerations, impacts or implications that Payments Canada should be made aware of?

a. The requirement of limiting the RTR functionality to account-based routing only, may well limit the versatility and future flexibility of the RTR going forward. In a 2017 report by Payments Canada, Modernization Target State, it was stated that:

The RTR will consist of multiple components that function together to enable participating PSPs to offer real-time payments…… Payments on the RTR may be originated either using an approved alias (e.g., email address, mobile number, or other unique aliases) or an actual routing and payment account number (page 20).

The move to limit the origination of payments to account-based routing only, will have the effect of adversely impacting Payments Canada's ability to claim they have acted in a manner consistent with their third legislated mandate:

5.(1) The objects of the Associations are to:

(c) facilitate the development of new payment methods and technologies.

To ensure the RTR has the greatest level of flexibility and future functionality, it is recommended that this decision be revisited to reflect the direction in 2017.

b. Consistent with the theme of "enhanced competition" please be aware that the lack of alignment between the roll out of the RTR, the implementation of the Retail Payments Oversight Framework and the intended policy directions (i.e., to be embedded in amendments to the Canadian Payments Act) creates an unacceptable series of potential delays that will adversely impact the prime audience for expanded membership: Payment Service Providers - PSPs.

Under the present scenario, the RTR is scheduled to "go-live" in early 2022, at least 12 months after the roll out of a competing RTR service through Interac, Interac Instant. The major incumbent financial institutions will enjoy a lengthy and significant first-mover advantage over any organization regulated under the RPOF and well in advance of any proposed amendments to the Canadian Payments Act, promulgating changes to the access/membership criteria for Payments Canada. Collectively, these delays will undermine much of the opportunity that PSPs/PayTechs seek to aggressively compete in the payments system.

Efforts must be aggressively pursued in offering Payment Service Providers access opportunities to Payments Canada's infrastructure. As history has shown in Canada and elsewhere in the world, account switching is problematic. The stickiness of account switching supports a strong case of first mover advantage; which must be avoided for the sake of, and **in the interests of users**.

c. Transaction Limits: We appreciate that setting a system-wide limit at the on-set of the RTR operations provides comfort during the live testing phase. However, if RTR participants have the right to set their own limits, why are a system-wide limits required at all?

The beauty and attractiveness of the RTR is in its ability to move money immediately and safely. The establishment of limits in a system that is effectively risk-proofed and tested does not seem necessary beyond the immediate term and may only add to the level of confusion amongst users. For example, a business that manages multiple accounts across several institutions could end up with several transaction limits, yet the risk profile is identical. Similarly, multiple individuals within a family-setting may experience different limits irrespective of the fact that this is a credit push system. As is required by credit-push systems, the paying institution authenticates and authorizes the payor, ensures sufficient funds exist and makes the pay/no pay decision. In the event of varied limits across users, the utility and value proposition of new payment-related (competitive) services may well be undermined.

d. DSPs and Settlement Agents: Historically, the Bank of Canada has set the requirements for securing a settlement account and the conditions/requirements for becoming a Direct Clearer in the ACSS. These requirements and the process to establish them have been less than transparent to potential most market participants. Given that Payments Canada has the overarching responsibility for the establishment and operations of the RTR, it is incumbent on Payments Canada to ensure all decisions affecting current and future participants are fully transparent.

The efficient operations of any payments system require that the rules and processes are fully understood and that its evolution is being managed properly. To this end, it is essential that there be a central repository of rules, requirements and policy positions that impact virtually every aspect of the RTR for broad scrutiny.

e. Centralized Fraud Management: After years of resisting a centralized service in support of fraud detection and management, Payments Canada now appears to have expressed support for such a service in the RTR. This is a positive and welcomed step forward and one that established a positive precedent going forward. Historically, many of the large incumbents have taken the view that certain services, like fraud management, should remain a competitive service, despite the obvious benefits from collaboration. A move to centralizing key functions and services in the national payments system should be held up as an important precedent. Many critical payment-related services like identify management or a central repository for authorization (e.g., pad agreements) could be easily centralized and in furtherance of the stated public policy objectives for the payments system, provide considerable value-add to a majority of members at Payments Canada and users alike.

f. Request to Pay:

There is potential to enhance both the safety of the payments system and its efficiency through the implementation of an effective "Request to Pay" model in the short to medium term. By examining other nations leading in this area, Canada can easily become a fast follower. As seen the EU under PSD2, consumers can authorise their bank to give third-party providers/PayTechs access to their account data, most commonly via application programming interfaces (APIs). Building upon this idea, some institutions have developed a three-corner model for its solution: facilitating a three-way interaction between the customer's bank, the customer and the merchant to safely and effectively remit payment to satisfy a bill or other obligation.

The current framework for bill payments is outdated, cumbersome and wrought with frictions that impede the ability of new billers/merchants to easily and quickly access this system. A Request to Pay framework will have the effect of driving volumes and reducing errors/chargebacks.

6. Do you have any concerns about employing the exceptions handling approach used in today's Payments Canada system direct credit payments in the RTR environment?

The process as described is in fact not really an exception handling process but rather a process to permit a new payment to be created, submitted into the RTR and either accepted or rejected. To this end, it seems the acceptance of the "return" and its subsequent initiation falls solely to the original recipient of the funds.

Under normal circumstances, it is likely to be assumed that the recipient of an erroneous payment would agree to return the full amount of the transaction. However, errors made due to purposeful fraud (e.g., account take-over) are not likely to be easily rectified. The result may well be that the account is scrutinized and possibly closed, well after the funds have disappeared. In a debit environment, the payee FI is liable for the return of the funds to the payor. In the RTR, the payor assumes all of the risk.

What seems absent in this discussion is a requirement that the Receiving Participant <u>must</u> respond within the 10 days; as opposed to "should respond". In the event that no response is provided, it is assumed that the request for return has been declined. One would expect that the Receiving Participant would seek out the advice of the “payee” before responding. In the event that the payee refuses to respond, the item cannot be returned and the fraud is complete.

If it can be shown that the payment was the result of a fraudulent activity, why wouldn’t the Receiving Participant be obligated to return the funds and they seek reimbursement from outside of the clearings/RTR?

Respectfully submitted,

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