



Canadian Payments Association

Association canadienne des paiements

The Canadian Payments Association

Playing a leadership role in providing a safe and efficient clearing and settlement system to meet the current and future payment needs of Canadians.

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THE CANADIAN PAYMENTS ASSOCIATION

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A - Mandate, Membership, & Governance

1. Mandate

The Canadian Payments Association (CPA) is a not-for-profit association established in 1980 by an Act of Parliament, which was amended and renamed the *Canadian Payments Act* (CP Act) in 2001. This legislation sets out the legal framework for the CPA, including its mandate, the types of organizations that are eligible for membership, the role of the Board of Directors and certain oversight responsibilities for the Minister of Finance.

The CPA's legislative mandate, as defined by the CP Act, is as follows:

- ⇒ To establish and operate national systems for the clearing and settlement of payments and other arrangements for the making or exchange of payments;
- ⇒ To facilitate the interaction of the CPA's systems with others involved in the exchange, clearing and settlement of payments; and
- ⇒ To facilitate the development of new payment methods and technologies.

The Act identifies public policy objectives for the CPA. As the operator of national clearing and settlement systems, the CPA is responsible for promoting the efficiency, safety and soundness of those systems, while taking into account the interests of users.

2. Clearing and Settlement

Every day, Canadians, businesses and governments use a variety of "payment instruments" to purchase goods and services, to make financial investments and to transfer funds from one person to another. These instruments include cash, cheques, debit cards and wire transfers to name a few.

Financial institutions need arrangements to transfer funds among themselves, either on their own behalf or that of their customers. This happens through clearing and settlement systems.

The CPA was created by Parliament to establish, maintain and operate a national system for the clearing and settlement of payments. The CPA establishes the rules and the standards by which its members transfer funds within our national payments system.

Clearing is the process through which CPA member financial institutions exchange and reconcile payment items made by clients and the calculation of net balances due to or from members prior to settlement.

Settlement is the process through which CPA members fulfill their net clearing obligations to other members by transferring funds between accounts held at the Bank of Canada based on the amounts owed to each other as calculated in the clearing process.

Clearing and settlement systems are essential to the smooth functioning of an economy. They provide the mechanisms by which customers of one financial institution can effect the transfer of funds to customers of another financial institution. Clearing and settlement systems allow financial institutions to calculate how much is owed to each other as a result of their customers' transactions and to transfer those funds to settle those balances.

The CPA does not see or physically touch any individual payment in the clearing system. Rather, at the end of every business day, CPA systems determine the net positions between financial institutions so that they can settle their accounts at the Bank of Canada.

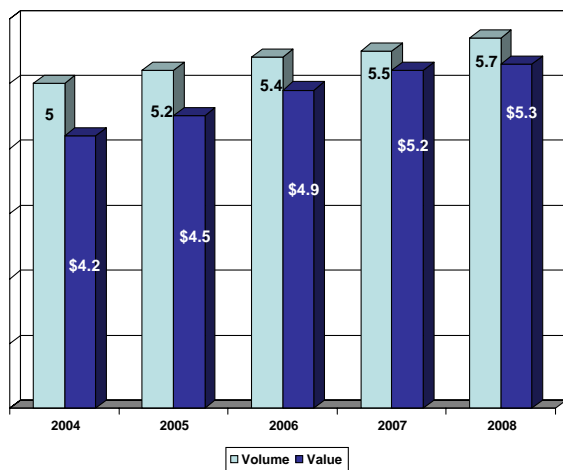
The CPA operates three main systems for the clearing and settlement of payments in Canada:

- *Large Value Transfer System (LVTS)* (wholesale system), through which Canadian dollar wire payments are cleared and settled, representing the bulk of the value of payments processed in Canada; and
- *Automated Clearing Settlement System (ACSS)* (retail system), through which Canadian dollar cheques and electronic payment items, such as direct deposits, ATM withdrawals, point of sale transactions, on-line payments, pre-authorized debits and Electronic Data Interchange (EDI) items are cleared and settled, representing the bulk of the volume of payments processed in Canada.
- The *U.S. Dollar Bulk Exchange (USBE)* is a parallel system to the ACSS used for payment items in U.S. dollars, drawn on and payable to accounts at financial institutions in Canada.

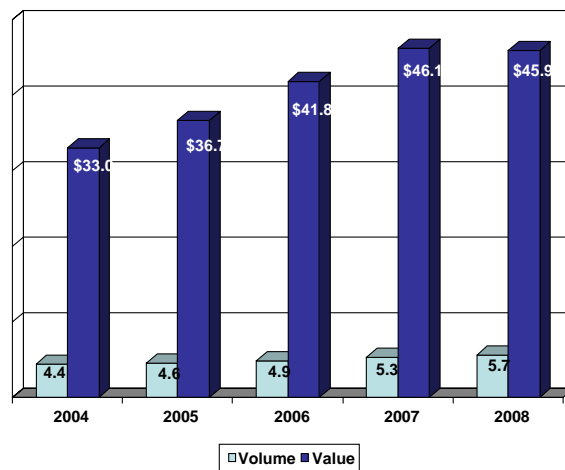
In 2008, the total value of transactions cleared and settled through these systems averaged almost **\$202 billion each business day**, with approximately 90 per cent of this value settled via the LVTS.

The CPA develops, implements and updates the rules and standards that govern the clearing and settlement of payments between its members. These rules and the related processes are central to the CPA's role in promoting the efficiency, safety and soundness of the clearing and settlement systems.

ACSS Transaction Volume (billions) & Value (trillions)



LVTS Transaction Volume (millions) & Value (trillions)



3. Membership

The Association's 136 members include the Bank of Canada, chartered banks, trust and loan companies, credit union centrals, federations of *caisses populaires* and certain other financial institutions. Most, but not all, credit unions and *caisses populaires* are represented through their provincial central. Since 2001, eligible organizations also include life insurance companies, securities dealers, and money market mutual funds.

4. Governance

The Association's governance framework is largely defined in the CP Act, including provision for a 16-person Board of Directors chaired by an official of the Bank of Canada. Twelve Board members are elected by the various classes of members: six by the bank class, two by centrals representing credit unions and caisses populaires, and four by the remaining membership classes. Three directors are appointed by the Minister of Finance.

CPA By-laws and rules are created under the authority conferred by the CP Act.

- ⇒ CPA By-laws are subject to approval by the **Governor-in-Council**.
- ⇒ The **Minister of Finance** has oversight responsibilities for the CPA. All proposed rule changes are reviewed and can be disallowed by the Minister as a mechanism to ensure the public policy objectives of the CPA in regards to the payments systems have been met.
- ⇒ The Governor of the Bank of Canada has oversight responsibility for the LVTS pursuant to section 4 of the *Payment Clearing and Settlement Act*.

Changes or new additions to existing by-laws, rules, standards and policies go through a rigorous internal and external consultation process. The CPA has a number of standing and special committees, which report to the Board (directly and indirectly), and provide advice, analysis, impact and risk assessments regarding various issues in the payments system. These committees give operational, risk and regulatory review and perspective to any potential changes to by-laws, rules, standards or policies.

The CPA's Stakeholder Advisory Council (SAC), established voluntarily in 1996 and enshrined in legislation 5 years later, comprises a wide range of payments system users, including representatives of consumers, retailers, the corporate sector and governments, as well as payment service providers. In addition, two CPA Board members are also members of the SAC and provide an important linkage between it and the Board. The SAC provides representation on other CPA committees and as such contributes user group perspective to the development of rules, standards and policies for the payments systems.

5. Consultation

A key ingredient in developing the rules applicable to the clearing and settlement of payment items is the CPA's effort to consult with various stakeholders during their development, particularly when dealing with new payment methods and technologies. As a result, consultation with users and stakeholders is an important part of the CPA rule development process. Consultation is in fact at the heart of the CPA legislated mandate and is an important mechanism to ensure the achievement of the public policy objectives.

As noted in Section 4, rule changes are developed through the member-based committee structure. Prior to submission to the Board, rules are referred to relevant committees for operational, regulatory, risk and user group perspectives. The SAC is an important part of this consultation process.

Significant rule changes follow an established public consultation process, which includes the release of a consultation document explaining the proposal and the rationale for the change and

could include education regarding the proposal through vehicles such as webinars, written documents, “town-hall” sessions and one-on-one meetings with key user groups, representing consumers, merchants, payment services providers and other identified stakeholders. Comments and concerns, whether written or verbal, are considered and addressed prior to requesting Board approval.

6. Funding

The CPA draws its operating funds from dues assessed to its members. The method for determining member dues is outlined in the CPA’s *By-law No. 2 – Finance*, which stipulates that the operating budget for CPA systems is shared by members based on their relative transaction volumes.

B - The CPA’s Public Policy Objectives

The *CP Act* provides that the CPA must “*promote the efficiency, safety and soundness of its clearing and settlement systems and take into account the interests of users.*”¹ Consumers, businesses, governments and payment service providers represent significant groups of system users, and as such, their interests are taken into account by the CPA in pursuing its objects. In addition to the SAC and a robust consultation process which seeks the input of these various user groups, CPA consciously addresses the need to consider the interests of those user groups when developing new rules or rule changes. It is important to understand that the CPA does not have a specific consumer protection role, but rather that it seeks to balance the interests of all users, of which consumers are but one.

The CPA seeks the input of a variety of representative groups in the rule development process. In addition to user group membership on SAC, the CPA seeks representation on key working groups/task forces that have been assembled to consider specific exchange, clearing and settlement issues. For example, the CPA’s Bill Payment Task Force has representatives from the Consumers Association of Canada, a large company that receives many bill payments and payment service providers. Further, the CPA meets with and receives input from key consumer groups during the development of rules that may impact consumers (e.g. the Consumers Association of Canada, Consumers Council of Canada, *L’Union des consommateurs*, *Option Consommateurs*, the Public Interest Advocacy Centre).

C - Attributes of the Canadian Payments System

The CPA’s payments systems encompass the set of procedures, agreements, arrangements, rules and standards that guide the exchange, clearing and settlement of the different types of payment instruments (e.g. cheques, direct deposits, debit card transactions). These elements (procedures, rules, standards etc.) underlie the key attributes of the Canadian payment system: safety and soundness, efficiency and accessibility, innovation and choice. The legal certainties created by this framework of rules facilitate the development of payment products and services by members and others for the benefit of consumer and corporate users of the payments system.

¹ Subsection 5(2) of the *CP Act*.

1. Safety and Soundness

Safety refers to ensuring the overall system is not compromised in terms of transactions flowing through the system, while *soundness* refers to a robust legal and regulatory framework which governs the system. Together, a safe and sound clearing and settlement system instils confidence in the payment system as a whole. The CP Act identifies the CPA's public policy objectives of promoting the "safety and soundness" of the national settlement systems. The CPA establishes policies and rules frameworks which address such issues as risk controls, authorization and authentication, and certainty and finality of settlement in order to ensure the safety and soundness of the overall system. Moreover, contributing to the soundness of the system is the requirement that all CPA members be regulated financial institutions with appropriate oversight.

2. Efficiency

Efficiency refers to providing optimum clearing and settlement systems at a reasonable cost. An efficient system is speedy, accurate and reliable. The CP Act identifies promoting efficiency as one of the CPA's public policy objectives for the national system.

The CPA's ACSS (also known as a "retail" payment system), has a robust underlying rules framework which has facilitated a wide range of payment options thereby allowing Canadians to access their deposit accounts no matter where they live or travel in Canada. The efficiency of the system has increased dramatically during the past decade as a result of the unprecedented growth in electronic payments. Our national system is speedy, accurate and reliable for both paper and electronic retail payments, evidenced by the fact that payments are usually final by the next business day.

The CPA also operates and establishes the rules, procedures and standards for the LVTS (a "wholesale" payment system) to facilitate the transfer of irrevocable payments across Canada. Through LVTS and the risk controls that are applied to that system, funds can be transferred between participating financial institutions virtually instantaneously, and the money can thus be credited to the recipient's account on a timely basis. All LVTS payments are immediately final and irrevocable.

3. Innovation and Choice

The CP Act defines one element of the CPA's legislative mandate as "to facilitate the development of new payment methods and technologies." The CPA does so by fostering innovation and choice through the development of rules, procedures and standards governing payment items which clear and settle through CPA systems. These frameworks establish the foundation by which CPA member institutions and others can develop new payment items and compete in the marketplace for business. As a result, consumers enjoy a wide range of choice when paying their household bills, purchasing their groceries and other goods and services. These options include debit cards, cheques, pre-authorized debits and on-line payments. Canadian governments and businesses have also benefited from innovation and choice. For example, they can choose to pay their employees, pensioners and other recipients by electronic direct deposit, offer their customers a host of different methods for bill payment, and improve their cash management and overall efficiency by receiving and making payments to other businesses electronically.

D - The CPA's Role with Respect to Electronic Payments

More and more people today are making electronic payments. Electronic transactions cleared and settled through CPA systems include:

- ⇒ Point-of-service payment items (such as ATM withdrawals and direct debit purchases at merchants),
- ⇒ Direct deposits (such as automatic payroll deposit),
- ⇒ On-line payments (payments initiated by a customer online for the purchase of goods or services)
- ⇒ Pre-authorized debits (for regular payments such as mortgages),
- ⇒ Bill payments (such as bill payments initiated via telephone and Internet banking)
- ⇒ Electronic data interchange transactions (business-to-business payments)

Today, 82% of the *volume* of all payments made in the ACSS is electronic as compared to 18% paper payments.

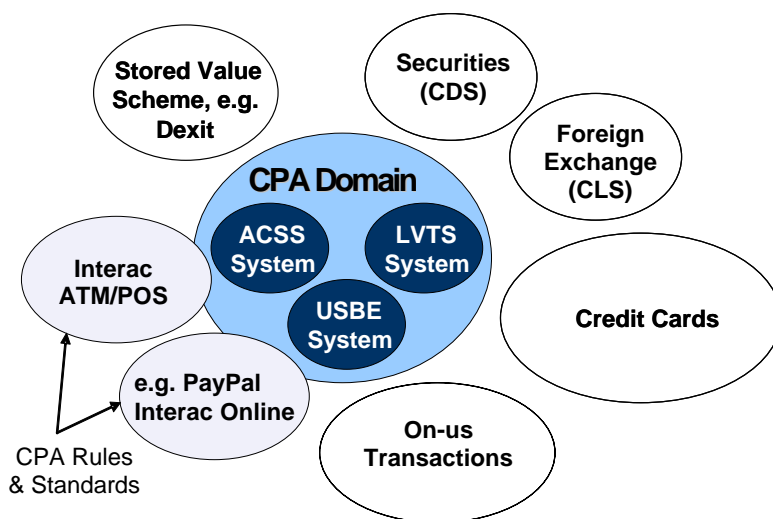
The Association's By-laws and rules set out the roles, responsibilities and liabilities of members involved in the clearing and settlement of electronic payment transactions.

E - Clearing and Settlement Outside of the CPA

The **CPA operates the main clearing and settlement systems for payments in Canada**. The CPA's rules govern the inter-member exchange of payment items when they have cleared and settled through CPA systems. While banks are required to be members of the CPA through the *Canadian Payments Act*, there are other clearing and settlement options they may use for certain payments.

Some payment systems operating in Canada fall **outside the scope of the CPA's** By-laws and rules. In the case of Interac and some third party payment processors like internet giant PayPal, for example, these systems make available their payment services directly to Canadians and use the CPA's systems for clearing and settlement; as such, most payments flowing through these systems are subject to specific provisions of the Association's rules and standards. For other types of payments, such as on-us transactions, credit card

payments, and certain closed-loop third party payment systems like pre-funded gift cards (e.g. retailers' gift cards), the CPA's retail clearing and settlement system is not relied upon and therefore the underlying CPA rules and standards are not applicable.



1. On-Us Transactions

“On-us” transactions are those where both payor (party authorizing the payment) and payee (party receiving the funds) bank at the same financial institution. In these cases, the financial institution is able to both debit the payor’s account and credit the payee’s account internally. Thus the transactions are processed internally at the financial institution, not through CPA systems, and therefore are not subject to the CPA’s By-laws and rules.

2. Credit Cards²

The credit card environment generally involves three distinct payments being made: 1) the initial purchase made using a credit card; 2) the exchange and netting between acquiring and issuing financial institutions; and 3) payment of the monthly credit card statement by the cardholder.

While it is true that credit card issuers and CPA members can be one and the same (e.g. banks), the clearing and settlement of individual credit card transactions occur through proprietary systems of the credit card companies which are not subject to CPA By-laws and rules. That is to say, when a purchase is made using a credit card, the cardholder’s account is credited via the credit card company’s clearing and settlement process, not the CPA’s.

At the end of the day, the netted amounts owing between the financial institution participants are to be settled. The members of the card associations may very well elect to settle the amount owing through CPA’s LVTS.

At the end of each month, when a consumer or business seeks to settle the balance of their credit card statement using either a cheque or on-line bill payment, that payment is generally cleared and settled through the CPA’s ACSS and is subject to applicable CPA rule.

3. Third Party Payment Service Provider (PSPs)

With the technological developments of instant communication and the changing attitudes of consumers in managing their own funds, market entry barriers to the payments marketplace have been reduced. Over the last decade, these change drivers have led to the fragmentation of the payments value chain. As CPA member institutions looked to new payment service providers (PSP’s) to out-source traditional lines of payments business, this created an incentive for non-traditional payment participants to emerge, which gave rise to the introduction of innovative products and services that challenged traditional payment models.

² The CPA has recently been advised that a major credit card association is planning to permit its members to issue card association-branded debit cards as a new product for Canadian consumers. Although virtually all debit card transactions were cleared and settled through the CPA in 2008, this credit card association’s debit card transactions will not be required to clear and settle through the CPA and the CPA rule frameworks will thus not apply.

The Payments Value Chain



With the growing prominence of non-financial institutions offering payments-related products and services, today PSPs may provide service such as bill payments or systems for pre-funded gift cards (e.g. retailers' gift cards). It is important to note that some, but not all of these payment transactions are processed through CPA systems. Only payment transactions processed through CPA systems are subject to CPA rules and standards.

4. Canadian Depository for Securities Ltd. (CDS) and Continuous Link Settlement Bank

The Canadian Depository for Securities Ltd. (CDS) manages the clearing and settlement of trades in domestic and cross-border depository-eligible securities. Participants are able to report, confirm or match, reconcile, net and settle exchange traded and over-the-counter equity, debt and money market transactions. The Continuous Link Settlement (CLS) Bank provides multi-currency cash settlement for foreign exchange payment using multilateral payment netting and a standard legal framework. Both the CDS and CLS operate entirely independently from the CPA from a governance perspective; however, there are interdependencies between CDS, CLS and the CPA's LVTS.

F - The CPA's Strategic Priority – The Way Forward

CPA has just drafted its [Long-Term Payments Strategy: Vision 2020](#) to ensure that it continues to fulfill its vision *to play a leadership role in providing a safe and efficient clearing and settlement system to meet the current and future payment needs of Canadians.*

The CPA's proposed strategy is to provide a common foundation to enable its members to competitively deliver modern payments services and offerings to Canadians and it is supported by four main pillars:

- ⇒ Facilitating Electronic Payments
- ⇒ Promoting Domestic and International Interoperability Standards
- ⇒ Enabling Framework and Systems; and
- ⇒ Supporting Value Added Services.

As the strategy will set the direction for the CPA in the medium term, it will be put through a rigorous public consultation process. The consultation process for CPA members, stakeholders and the public is set to begin in mid May and will include Webinars, written consultation, and five "town-hall" sessions across Canada. The input received will be considered in finalizing the CPA's payments strategy.

The proposed strategy is founded in broad and sound research regarding payments and payment systems both domestically and internationally and will incorporate feedback from the many users of the CPA's systems. It asks important questions regarding the development of Canada's national clearing and settlement framework and systems for the next decade, such as how best to facilitate innovation and international interoperability. The CPA believes this research and feedback will strengthen the strategy and will lay the solid foundation for efficient, safe and sound clearing and settlement systems, which balances the interests of all its users for years to come.

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