



**PAYMENTS  
CANADA**

CONSULTATION

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# MODERNIZING ACSS ACCESS

NOVEMBER 2018

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## Introduction

A key objective of Payments Canada's Modernization Program is to enhance the framework of rules and by-laws to ensure they remain relevant, reflect current market practices, achieve an appropriate balance between flexibility and compliance, and facilitate innovation. As part of these efforts, we are exploring potential opportunities to broaden access to the Automated Clearing Settlement System (ACSS). With a goal of ensuring objective, risk-based criteria for participation in the ACSS that permits fair and open access, this paper sets out the following proposals:

1. Removing the 0.5 per cent volume requirements for direct participation in ACSS as set out in [By-law No. 3 – Payment Items and Automated Clearing Settlement System](#) (see sections 26 and 29).
2. Introducing ACSS rule amendments that would restrict the direct participation of affiliated (i.e., related through any type of control or ownership) members in the ACSS.
3. Retaining the institutional restrictions for direct participation as set out in section 32 of By-law No. 3.<sup>1</sup>

Interested parties are invited to provide comments regarding these proposals by Friday, January 18, 2019 to [consultation@payments.ca](mailto:consultation@payments.ca).

## Context

The ACSS is where the vast majority of payments in Canada are cleared, including cheques and other paper items, direct deposits, pre-authorized debits, bill payments and point-of-sale payments. Although it handles 99 per cent of the daily transaction volume, it only accounts for 13 per cent of the value cleared by Payments Canada's systems.

### Determining Eligibility for Access to the ACSS

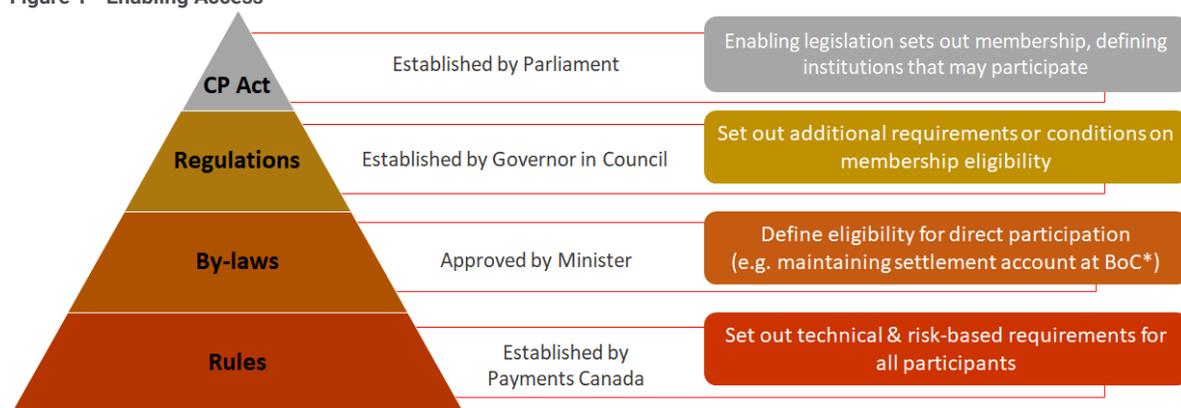
While Payments Canada has a role to play when it comes to defining eligibility to directly participate in its systems, Payments Canada does not define eligibility alone. Eligibility to access Payments Canada's systems is ultimately established by Parliament in statutory instruments (i.e., the *Canadian Payments Act* and associated regulations and by-laws).

As set out in Figure 1, the *Canadian Payments Act* is the enabling legislation that sets out required and eligible membership, defining the institutions that may ultimately be able to participate in the payment systems (see Figure 1). Eligibility for participation by members on our systems is then determined both by by-laws and rules. The Bank of Canada also plays an important role, defining if a member can have access to an ACSS settlement account and loan facilities, which are required to be an ACSS participant.

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<sup>1</sup> A qualified corporation, on behalf of its money market mutual fund, a trustee of a qualified trust and a life insurance company are not eligible to be a direct clearer or group clearer.

Figure 1 - Enabling Access



\*The Bank of Canada sets out eligibility criteria and requirements for obtaining a settlement account. These criteria and requirements do not form part of Payments Canada's by-laws and rules.

## Drivers for Modernizing ACSS Access

### Calls for more open, risk-based access

Some Payments Canada members seeking greater access have voiced concerns about barriers to participating directly in the ACSS. Broader access to the core clearing and settlement infrastructure will enable members to compete in a more balanced way. Payments Canada has also heard from businesses and payment service providers that enabling greater access could result in more competitive payment services options for end users.

The broader ecosystem has also suggested that our current access framework should be modernized. For example, the Competition Bureau recently pointed out that industry participants find the lack of access to our systems to be the largest barrier to entry into the retail payments marketplace. The Competition Bureau suggested that Payments Canada review its policies to allow a broader base of participants to obtain direct access to the ACSS.<sup>2</sup>

### Regulatory Drivers

Under the *Payments Clearing and Settlement Act*, the ACSS has been designated for oversight by the Bank of Canada. The Bank of Canada's Risk-Management Standards for Prominent Payment Systems (PPS Standards), which are based on international risk management standards known as the CPMI-IOSCO's Principles for financial market infrastructures, provide guidance on access to payment system infrastructure (see Figure 2). These regulatory expectations have led Payments Canada to review the ACSS access criteria.

<sup>2</sup> See *Technology-Led Innovation in the Canadian Financial Services Sector* by the Competition Bureau (2017).

Figure 2 - Bank of Canada's Risk Management Standards for Prominent Payment Systems

#### Prominent Payment Systems Standard 13 - Access

- A PPS should have objective, risk-based and publicly disclosed criteria for participation that permit fair and open access.
- A PPS should allow for fair and open access to its services, including by direct and, when relevant, indirect participants, payment service providers and other FMIs based on reasonable risk-related participation requirements.
- A PPS's participation requirements should be justified in terms of the safety and efficiency of the PPS and the markets it serves, be tailored to and commensurate with the PPS's specific risks and be publicly disclosed.
- Subject to maintaining acceptable risk-control standards, a PPS should endeavour to set requirements that have the least-restrictive impact on access that circumstances permit.
- A PPS should monitor compliance with its participation requirements on an ongoing basis and have clearly defined and publicly disclosed procedures for facilitating the suspension and orderly exit of a participant that breaches, or no longer meets, the participation requirements.

### Proposals to Modernize ACSS Access Criteria

Considering industry and regulatory calls for more fair and open, risk-based access criteria, Payments Canada is proposing the following regarding a member's eligibility to become a direct participant in the ACSS:

1. Removing the 0.5 per cent volume requirements;
2. Introducing a restriction on the direct participation of affiliated members; and
3. Retaining the institutional restrictions that are currently set out in By-law No. 3.

#### 1. Expanding Eligibility – Removing the Volume Requirements

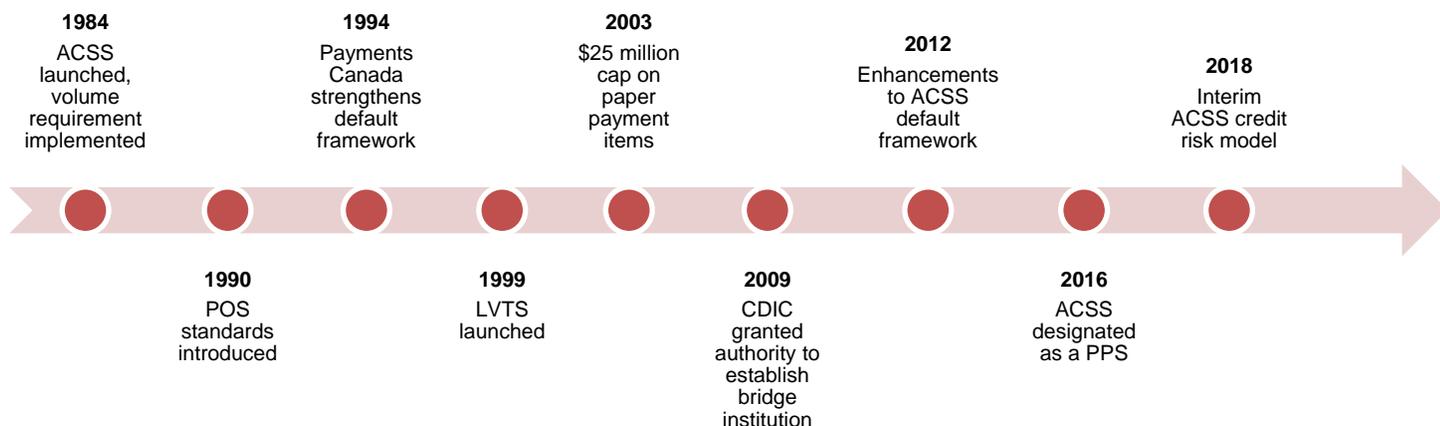
*By-law No. 3 – Payment Items and Automated Clearing Settlement System* sets out that, on completion of the application procedures, the board may only appoint a Payments Canada member to act as a Direct Clearer if the member has payment items volume of no less than 0.5 per cent of the total national volume of payment items giving rise to clearing through the ACSS.<sup>3</sup> Similarly, a member can only act as a Group Clearer if the Group Clearer and the other entities belonging to the group have an aggregate payment items volume of no less than 0.5 per cent of the total national volume of payment items giving rise to clearing through the ACSS.<sup>4</sup> **Payments Canada is proposing the removal of these volume requirements.**

The current ACSS volume requirements were put in place in the early 1980's as a risk management tool. Limiting the number of Direct Clearers/Group Clearers in the ACSS was important to preserve a trust relationship among participants in an environment that was significantly different than it is today. At the time, the ACSS replaced a clearing process which involved participants meeting each morning and manually calculating net balances from the previous day's clearing. The volume requirements were put in place prior to the advent of Point-of-Service (POS) transactions, which now make up the vast majority of ACSS volumes (representing greater than 60 per cent of the total ACSS volume today). The ACSS default and unwinding frameworks at the time introduced potential operational and legal uncertainties. Furthermore, the prudential regulation and supervisory framework under which Payments Canada's members operated was not as sophisticated as it is today.

<sup>3</sup> Canadian Payments Association By-law No. 3, Payment Items and Automated Clearing Settlement System, s. 26.

<sup>4</sup> *Ibid.* s. 29.

Figure 3 - Evolving Environment



In addition, as set out in Figure 3, the framework for managing risk in the payments system has matured significantly over the past 30+ years. When the volume requirements were established, prior to the introduction of the Large Value Transfer System (LVTS) and the \$25 million cap on paper in the ACSS, the ACSS was more integral to financial stability and needed more restrictive access criteria. The introduction of the LVTS significantly reduced the value cleared in the ACSS. While less integral to financial stability since the introduction of the LVTS, the ACSS has since been designated as a prominent system. The ACSS is now subject to the Bank of Canada’s PPS Standards, which seek to mitigate a wide range of risks. An Interim Credit Risk Model (ICRM) has been introduced, collateralizing the ACSS to cover the credit exposure arising from the default that would generate the largest credit exposure in extreme but plausible market conditions (i.e. with a 99 per cent<sup>5</sup> confidence level).

A member’s payment volumes are not necessarily indicative of the operational and financial capability to clear and settle in today’s environment. Considering the evolving environment, such as the advent and proliferation of electronic exchange, the introduction of greater risk controls and more robust supervisory and prudential oversight, it is no longer necessary to manage risks by prohibiting the participation of members that have smaller volumes. Risks can be effectively managed through the more comprehensive framework that underpins the ACSS of today.

In addition to the risk controls noted above, Payments Canada’s existing framework also establishes comprehensive security standards and requirements for ACSS work stations, payment items and network connections, including measures to protect the ACSS infrastructure, data and equipment from both physical and cyber threats/harm. These requirements, along with additional operational and technical requirements for Direct Clearers/Group Clearers, are set out in the rules, service level descriptions, user guides and the Payment Items Information Security Standard (Standard 18). The framework seeks to mitigate and manage risks related to direct participation in the ACSS and is regularly reviewed to ensure safety and soundness of the payments system.

<sup>5</sup> Amendments to increase the confidence level from 97 per cent to 99 per cent was approved by the Board on November 29, 2018 and will come into effect following the Ministerial review process in February.

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## 2. Restricting Affiliate Participation

Removal of the volume requirements will result in a wider range of member institutions being eligible to become Direct Clearers/Group Clearers. Some of those newly eligible institutions may be affiliated (i.e., related through any type of control or ownership) with current Direct Clearers/Group Clearers. Direct participation by affiliates introduces a new risk; for reasons external to the ACSS, it brings a potentially elevated probability of simultaneous defaults of affiliated participants. However, the ICRM has been designed to cover *ex ante* the default of only the single largest direct participant, which means, in the event of simultaneous defaults, it is more likely that the collateral pool will not provide sufficient coverage of settlement obligations and surviving participants will need to make contributions to cover the defaulters' shortfall. **To address this risk, Payments Canada proposes that direct participation in the ACSS should be restricted to only one entity in a group of entities that are related through any type of control or ownership.**

**In addition to an affiliate restriction, Payments Canada is proposing a process for off-boarding a Direct Clearer/Group Clearer should it become affiliated with another Direct Clearer/Group Clearer.** Payments Canada is proposing that an affiliated Direct Clearer/Group Clearer must withdraw from direct participation within one year of the effective date of the affiliation. Payments Canada's president and CEO may extend the one-year period if it is necessary for the proper conduct of the business of the affiliated members. This is consistent with the off-boarding provisions in By-law No. 3 for members that have amalgamated. Additionally, during the one-year transition period, Payments Canada may require additional risk controls (e.g. collateral requirements to the affiliated Direct Clearers) that may be appropriate in the circumstances, subject to consultation with the Bank of Canada and any affected members.

It is important for the affiliate off-boarding requirements to be flexible because the facts and circumstances of an affiliation could change the necessity and feasibility of the available risk controls. These facts and circumstances could include such considerations as the likelihood that the non-viability of one Direct Clearer/Group Clearer would trigger the non-viability of the other, the values and volumes of the affiliated Direct Clearers/Group Clearers, and the clearing and settlement relationships the affiliated Direct Clearers/Group Clearers may have with other ACSS participants.

## 3. Retaining the Institutional Restrictions

By-law No. 3 currently restricts a qualified corporation, on behalf of its money market mutual fund, a trustee of a qualified trust and a life insurance company, from being eligible to become a Direct Clearer or Group Clearer. At the time that this restriction was put in place, there were concerns about policy-holder preference in the event of a life insurance company's insolvency and the risk this might bring to the ACSS should the member default. Similarly, there were complex legal issues surrounding solvency of money market mutual fund companies that may not make it possible for them to become Direct Clearers/Group Clearers in the ACSS. There were questions around the ability of investment dealers to borrow sufficiently and the timeframe of settlement for mutual funds, which could cause operational constraints if they were direct participants. As some of these risks and complexities continue to exist today and there are no pressing demands from these industries to have direct access, **Payments Canada proposes that these institutional restrictions continue to exist in By-law No. 3.**

## Next Steps

### Managing Onboarding of Potential New Direct Clearers/Group Clearers

Removing the 0.5 per cent volume requirements will enable more members to be eligible to become Direct Clearers/Group Clearers; however, it should be recognized that a significant amount of work is

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involved in actually becoming a Direct Clearer/Group Clearer. The application and on-boarding processes have implications to Payments Canada, the Bank of Canada and other participants. On-boarding activities need to be carefully coordinated with each of these parties in an efficient way that appropriately manages risks. In recognition of the complexities involved in becoming a Direct Clearer/Group Clearer, Payments Canada is developing an *Onboarding Process Document* and a *Member Playbook for Becoming an ACSS Direct Clearer*. These documents are being developed with input from members and are available upon request.

### Future Opportunities to Enhance Access – Decoupling Exchange from Clearing & Settlement

Payments Canada recognizes that some current ACSS Indirect Clearers have expressed an interest to have direct access to Payments Canada's exchange networks but do not wish to participate as Direct Clearers in the ACSS. Broadening access to exchange could provide more flexible arrangements for members, promoting greater competition and efficiencies. For example, direct exchange participants would be able to process incoming and outgoing files more rapidly than they can today, as well as better manage their credit exposures to clients.

There is a desire from some Indirect Clearers to enable decoupling prior to the implementation of any potential future plans for centralization of exchange of retail batch payments, a key element of Payments Canada's modernization program. In this regard, Payments Canada will undertake to consider the implications to its current framework and welcomes input from members on the related benefits, implications and concerns that should be addressed.

### By-law & Rule Amendments

Payments Canada will consider any feedback provided by interested members and stakeholders and finalize the proposals set out in this paper. Amendments to By-law No. 3 will be required for the removal of the 0.5 per cent volume requirement. Proposed changes to By-law No. 3 will be discussed with the Bank of Canada and Finance Canada and will proceed through the regulatory approval process, including the [Canada Gazette process](#), before becoming final. The removal of the 0.5 per cent volume requirements and the proposal on restricting direct participation of affiliates will require rule amendments. Prior to seeking Payments Canada board approval of any rule amendments, draft amendments will be reviewed by Payments Canada's Senior Operational Committee.

### Conclusion

Payments Canada welcomes input on the proposals set out in this paper. Questions and comments can be sent to [consultation@payments.ca](mailto:consultation@payments.ca) by January 18, 2019.