

Task Force for the Payments System Review

# Policy Paper B: Governance

## Stakeholders and their Disconnect

December 2011

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# Policy Paper B: Governance

## —Stakeholders and their Disconnect

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## Executive summary

### *Governance challenge*

The payments system is built on networks, which means that a certain amount of coordination and collaboration is essential for it to function and develop over time. The challenge is to encourage stakeholder collaboration that supports innovation and competition while discouraging collective or individual behaviours that are detrimental to payments system users.

Moreover, the regulatory framework is fragmented and lacks unified oversight in the public interest. Until now, the government's focus has been on specific issues, addressing challenges involving individual payment types or practices. For example, the recent *Payment Card Networks Act* gives the government the ability to address specific public policy concerns relating to credit and debit cards. Such a reactive approach can create uncertainty in the industry as to which collaborative or competitive behaviours will be challenged and which will not.

A more proactive and longer-term solution is required, especially because the industry will be characterized by rapid, discontinuous change, making it hard to predict where underlying frictions may surface. A prescriptive, heavily regulated industry must be avoided, because it will become obsolete as markets change. Instead, the framework needs to be flexible, adaptable and collaborative.

### *Governance models in other jurisdictions*

The Task Force explored examples of payments system governance around the world, specifically in the United Kingdom, the European Union, the United States and Australia. These models helped define the range of possibilities and confirmed the views of the Task Force:

- It is possible and desirable to view the payments system as an industry separate and distinct from banking.
- Primary responsibility for finding optimal solutions to market challenges can be successfully placed in the hands of stakeholders, both users and providers. In other words, self-governance is feasible and appropriate.
- Some form of public oversight is necessary and must be carried out in a manner that is principles-based and aligned with the public interest.

The Task Force also looked at examples of self-governance in the securities and accounting industries in Canada. The Ontario Securities Commission, an oversight body and adjudicator for self-regulating organizations, strikes a good balance between ensuring that the public interest is served and providing the industry with the opportunity to self-organize and to influence the evolution of the market.

The Task Force found that the Ontario Public Accountants Council also demonstrates the benefit of mobilizing the expertise available in the private sector to set standards and drive collaboration, while ensuring independent oversight for the public interest.

## ***Assessment of governance options***

Following extensive consultation with experts and stakeholders, the Task Force outlined an ideal governance model, based on the following:

- **Full participation:** Providing all stakeholders, including users, with the opportunity to participate as full members of the governance process.
- **Mandatory application:** Requiring certain stakeholders to be subject to the decisions reached within the governance framework.
- **Collaboration:** Promoting dialogue and collaboration among stakeholders.
- **Oversight mechanism:** Ensuring that the overall governance process does not stray from its broader objectives and to serve as an “appeal” process.

## ***Recommended governance model***

The recommended governance model for the payments system has three key elements: 1) a self-governing organization, 2) a public oversight body, and 3) a core infrastructure entity. All three bodies and their functions would be defined in new or amended payments legislation.

### ***1. Self-governing organization***

The Task Force envisages the self-governing organization (SGO) as providing a platform for broad-based collaboration and strategic thinking for the industry as a whole. The mechanism proposed for Canada would be significantly more inclusive than other payments bodies around the world. It would bring together banks, other financial institutions, payment card networks, acquirers, and new-entrant payments service providers. It would also include representatives of a user stakeholder community that includes consumers, merchants, small and medium enterprises, large corporations and governments.

To draw on the private sector’s ability to adapt and respond quickly, the SGO would be formally recognized by the public oversight body. It would consist of two broadly defined groups of members: payments industry players who would be defined by the legislation and subject to the decisions of the SGO, and users participating and providing input on a voluntary basis.

### ***2. Public oversight body***

Government would continue to be responsible for protecting the public interest. Under the ultimate direction of the Minister of Finance, this role would be fulfilled by a public oversight body (POB). The POB would delegate much of its regulatory and policy-making mandate to the SGO but retain the right and requirement to ratify strategies of the SGO and to review its performance. The POB would also provide recourse for stakeholders who could not resolve concerns within the SGO.

### ***3. Core infrastructure entity***

The final element of the recommended framework is an entity to provide the required core infrastructure, including clearing and settlement, debit transactions and, potentially, cheque processing. This entity would be created through a legislative transformation of the Canadian Payments Association (CPA). The current policy role of the CPA would be assumed by the SGO.

### ***Implementing the recommended model***

The Task Force recommends legislation that creates a distinct payments industry in which the public interest is broadly defined and identified through a principles-based approach. Legislation is also needed to create the new POB and to reinvent the CPA's governance and business model to enable it to serve as the payments system's core infrastructure entity for the future.

The recommended governance model would be paid for by users through a very small fee on each payments transaction.

The implications of the new governance model for the roles played by existing regulatory players, including the Minister of Finance and the Bank of Canada, as well as for the CPA, would need to be addressed.

To move the work forward, the Task Force recommends the following:

- That government begin developing the legislation necessary to define the payments industry and implement the recommended governance model, and
- That stakeholders begin working in earnest to create an entity that will become a self-governing organization under the new governance model.

## Introduction

Effective governance is essential to the future success of the Canadian payments system. In *Policy Paper A: Users and their Discontent*, the Task Force explored the current payments system from the perspective of its various users—consumers, merchants, small and medium enterprises, not-for-profit organizations, and large corporate and government entities—and outlined some of their difficulties and dissatisfaction with existing payments services.

We went on to lay out the principles on which the payments system should be based in order to ensure that users' concerns are addressed and that available technologies are fully utilized. Key to the success of that approach would be flexibility, adaptability, collaboration among the players and the maximum possible degree of self-governance, but with a carefully calibrated oversight mechanism to ensure that the payments system is broadly aligned with public interest objectives.

This paper describes the governance model needed to support such an evolution of the payments system in Canada. The papers that follow this one examine how that model can be supported in legislation (*Policy Paper C: Legislation—Establishing the Payments Industry*) and how the infrastructure can be built for a payments system that supports the digital economy (*Policy Paper D: Infrastructure—A Reinvented Canadian Payments Association*).

To improve the payments system, both users and providers need to contribute to establishing effective collaboration. Users still do not have a real seat at the table; they cannot be members of the Canadian Payments Association (CPA), and the CPA Stakeholder Advisory Council has not been an effective working forum for consumers and other users to engage providers in a dialogue about issues and solutions.

Moreover, the payments business is changing. New types of providers are emerging, offering inventive payment solutions throughout the payments value chain. Innovations regularly make headlines, featuring firms not historically associated with the payments business. Telecommunications and technology companies, and a host of other businesses, are now an integral part of a landscape once dominated by banks and other financial institutions.<sup>1</sup> Lack of collaboration between users and providers in such a situation may bring action, but it will mean that little real progress is made.

Although their importance varies between payment types, networks and standards remain a critical part of facilitating payments. This is one reason that providers must work together in order for real innovation to be possible. Moreover, users' needs and providers' proposals are increasingly complex. If stakeholders do not communicate and collaborate more effectively than they have in the recent past, needs will remain unmet and new products will fail. We must avoid that scenario if our economy is to remain efficient and competitive in the world market. Inefficiencies in the payments system result in inefficiencies throughout the Canadian economy.

All stakeholders are involved in the problem, if only because they are affected. They need to become active parts of a collaborative solution. As noted below, however, collaboration can also have negative effects on the evolution of the payments ecosystem, because some incumbents

may have undue market power. Legitimate self-interest must be balanced with a broader understanding of the long-term development of the payments system as a whole.

The Task Force believes that the solution lies in embracing the collaborative potential of the payments system through a renewed governance model. The system will thrive if all stakeholders have an opportunity to participate in that collaborative process, if responsibility for achieving the broader public policy objectives is placed on their collective shoulders, and if an oversight mechanism is provided to intervene quickly and flexibly should that responsibility not be met.

In other words, the Task Force recommends that a new, inclusive and responsive governance model be implemented for the Canadian payments system.

This paper expands on the development of a new governance model for the payments system, a core Task Force recommendation. It outlines how the Task Force arrived at its recommended governance model, how the challenges identified by stakeholders shaped our thinking and how governance models in other jurisdictions and industries helped us work toward an optimal solution for Canada.

#### **Box B1: What do we mean by governance?**

In this paper, we consider governance to be the complex process by which the relevant laws, institutions, policies, customs and relationships collectively shape the direction of an industry. When we speak of governance, we are referring to how the individual and combined decisions of all stakeholders—not just those of government—are made and implemented. Key to understanding this process is how the formal and informal participants in an industry, and the relationships they form, shape these decisions.

## **Governance challenge**

The Task Force came to focus on governance as a result of its efforts to understand the challenges facing the payments industry and the needs of its users (see Annex B1 for an overview of the current governance framework). Starting early in our mandate, we sought to understand the strengths and weaknesses of the system by seeking input from stakeholders. The Task Force analyzed this input through the lenses of user protection, market conduct, and effective functioning of the payments system (competition and innovation). We also participated in the Scenarios Roundtable, where leaders from a cross-section of users, incumbents and new entrants gathered to discuss the Canadian payments system and to develop plausible scenarios for the future.

It seemed clear to us from these explorations that many problems arose from the sometimes-wide gaps between the expectations of those who provide payments services and those who use them. The experience was especially vivid in the working groups. In some cases, the meetings were the first opportunity that providers and users had had to discuss the crucial issues in a given area, to understand their respective challenges beyond the specific features of a product (that one party wanted to sell and the other party did not want to buy, or vice versa), and to share possible

solutions. The whole process was disquieting but highly enlightening for the Task Force; we hope that it was just as useful for stakeholders.

Based on this experience, *Policy Paper A* presented an analysis of the challenges facing users of the payments system and proposed principles that we believe must drive the effort to achieve reform. From that analysis, we concluded that the fragmentation of the current payments system comes in large part from a reactive, disconnected and ad hoc approach to addressing its problems. The solution we arrived at starts from the simple notion that what matters most is getting governance and oversight right so that the system can, as much as possible, steer itself in a direction that serves all stakeholders, both users and providers.

## **Encouraging coordination**

The payments industry is built on networks, because payments usually require that two parties connect with each other to transfer funds and information. Standards have long played a critical role in the evolution of payment products by ensuring, for example, that retailers need only one card terminal for a variety of debit and credit cards and that Canadian credit cards are accepted around the world. Competitors therefore must find a way to work together to establish standards and agree on rules to ensure interoperability.

Developing the rules that enable payments also requires collaboration and coordination, and may involve large investments in infrastructure with no concrete assurances that consumers will migrate to the products that are enabled. Users must therefore be engaged. Providing consistent and understandable user protection is another area where stakeholder collaboration is needed. As noted in *Policy Paper A* and further discussed in *Policy Paper D*, these important instances of stakeholder collaboration happen too seldom in Canada. And despite the essential role of collaboration and of bringing providers and users together, there is currently no single organization that provides a coordination function for interests across all aspects of the payments system in Canada.

## **Reactive government involvement**

Many industries thrive with little need for a formal governance model. Market forces can drive efficient outcomes that benefit consumers and reward successful businesses. However, in certain industries the nature of the business may call for greater government intervention to satisfy public policy objectives. This has generally been the case in the financial services industry, which is characterized by governance models that rely on prescriptive regulation and active oversight.

The Task Force believes that the payments industry deserves special attention in terms of improved governance, but it does not believe that this governance should take a prescriptive form. As noted, the payments industry requires collaboration and coordination among competitors for its development. Not surprisingly, many payments networks have their roots in member associations whose original purpose was to develop the standards needed to introduce payment products.<sup>2</sup> While collaboration among participants may be needed to develop payment technology, that collaboration can lead to barriers to entry. It can also result in user rules that reduce the overall

benefit of those networks or prevent them from aligning with the interests of other stakeholders, those of the public, or indeed the needs of the economy as a whole.<sup>3</sup> A key policy challenge lies in encouraging productive coordination while discouraging behaviours that are detrimental to payments system users.

Importantly, although there is a generally recognized need to counter the potential negative effects of individual or collective actions in a network-based industry, there is no public entity tasked with ensuring that the decentralized decision-making processes that drive change in payments services align with the public interest. Instead, disaffected stakeholders must turn to various levels of government to seek redress, which tends to be provided on an ad hoc basis. Recent examples of government intervention include the development of the *Code of Conduct for the Credit and Debit Card Industry in Canada*,<sup>4</sup> the bringing of antitrust cases by the Competition Bureau against credit card companies and issuers for alleged restrictive trade practices, and the passing of provincial legislation governing gift cards.

Governments certainly hold some of the most powerful governance tools, including legislation, regulation and oversight. They are not restricted to these tools, however. They can also use moral suasion or the threat of regulation to modify behaviour, or they can use their significant role as a user to effect positive change. Too often, however, the available tools tend to be used in a negative and prescriptive way.

## **Proactive self-governance roles**

The Task Force concluded that the payments system needed a more proactive, longer-term solution, rather than a reactive and prescriptive model of oversight and governance. This is particularly so because, as our report *Going Digital* points out, the industry will be characterized by rapid, discontinuous change, making it difficult to predict how the payments system will evolve and, more significantly, where the underlying frictions may surface. This means that we must avoid a prescriptive approach that creates a heavily regulated, slow-to-adapt industry that becomes obsolete as the markets change. Instead, the model needs to be flexible, adaptable and collaborative.

Moreover, to protect the public interest in a non-prescriptive way, the payments system and its participants need to be guided by principles. To this end, the Task Force has adopted the three broad principles of *trust*, *access* and *good value* developed by the Consumer Advisory Group. These principles are introduced in *Policy Paper A* and further elaborated on in *Policy Paper C*.

It is with such constraints in mind that we have looked at the possible contribution of the private sector to the necessary change, and it could be significant. Businesses and their customers have the capacity to organize and develop the relationships necessary to change the orientation of the industry without having to appeal to government. They know the issues, and they have a stake in finding workable solutions. We know, however, that in markets as concentrated and technically specialized as payments there is a considerable challenge in ensuring that providers and users have an equal chance to be heard.

**Box B2: Initial thinking on principles for governance of the payments system**

As a first step in our search for governance options, the Task Force sought appropriate principles, goals and functions for an effective governance model. Our initial thinking—as outlined in *The Way We Pay*—focused on the following:

- a) **Consistent standards:** Rules are consistent across payments types to protect interoperability and to ensure consistency in the protection of consumers.
- b) **Light regulation:** Regulation exists only to the extent that it is necessary to correct market failure; market forces are left to work so long as the public interest remains protected.
- c) **Neutrality by function:** Standards and rules are based on the function being performed, not on the entity performing it.
- d) **Proportionality:** Protection takes into consideration the risk involved (e.g., transaction size).
- e) **Independent and inclusive:** The payments system remains open and accessible to all eligible players.
- f) **Framework adaptability:** The preferred governance model is flexible and sufficiently robust to remain relevant over time.

As explained in *Policy Paper C*, the form of these principles has evolved over time, but their spirit remains valid.

Given the current state of our payments ecosystem and the speed at which it is likely to change in the coming years, a flexible, adaptable and collaborative governance model would best foster successful evolution. Users and providers should be given the opportunity and the means to work together to address the transformations that are required. It is in this spirit that many of the recommendations of this paper are rooted, especially our recommendation that payments system stakeholders come together to form a self-governing organization.

## Oversight

We acknowledge that there may be issues that are beyond stakeholders' ability to resolve and that the self-governance model we are recommending may fail at times. Consequently, there needs to be a safety net, and the government needs a mechanism to ensure that it has a holistic view of developments in the payments system and of how it is evolving. We therefore recommend the creation of a public oversight body to assist the Minister of Finance in ensuring that the interests of both providers and users are adequately addressed by the new self-governing organization, and to guarantee that the public interest is adequately protected at all times.

Finally, as we discuss in *Policy Paper D*, a reinvented CPA is needed to manage the core infrastructure that supports the payments system.

## Seeking an optimal governance model

In its search for a suitable governance model for the Canadian payments industry, the Task Force began with a review, undertaken by the Governance Advisory Group, of payments governance models in jurisdictions around the world. We also looked at examples of self-regulation in other industries. We assessed the various possibilities that emerged and discussed them extensively with a wide range of experts and stakeholders.

### Governance models in other jurisdictions

Many jurisdictions have struggled with the policy challenges posed by their payments industries. The Task Force was particularly interested in countries whose models recognize the important role of collaboration in the future of the industry. We also looked for models that could provide oversight of the Canadian payments system and help reduce its fragmentation.

As a result, although we looked at many others, our research focused on models implemented in the United Kingdom, the European Union, the United States and Australia. In these economies, payments system participants have come together to form bodies, tackle common opportunities and challenges, and set strategies. Each jurisdiction features a body that plays a central role in coordinating the interests of stakeholders.

Many of these bodies bring distinct benefits to their national or regional payments systems and have novel governance arrangements. They also have weaknesses, however, including limited membership and spheres of influence, as well as inadequate stakeholder consultation mechanisms.

Some of our findings from the international comparisons are summarized below. Details can be found in Annex B2.

#### *United Kingdom—Payments Council*

The United Kingdom (U.K.) model for governance of the payments system now relies in significant part on an industry-led Payments Council. The Payments Council was created at the urging of government authorities to serve as a strategy-oriented body at the top of the payments system, to facilitate competition and to reduce the influence of banks in the payments system by augmenting the presence of other stakeholders. Its board structure was determined through public–private negotiations, as was its mandate, which is as follows: 1) to lead the future development of cooperative payment services in the United Kingdom; 2) to ensure that the payment system is open and accountable; and 3) to ensure the operational efficiency, effectiveness and integrity of payment services. The U.K. government’s Office of Fair Trading, which directed the implementation process, periodically evaluates the performance of the Council against its mandate, publishing its findings to influence the actions of the Council. The Council sets a broad national payments strategy and is responsible for its implementation, a feature that seems to have had a positive impact on the evolution of this particular payments system.

The U.K. approach is currently characterized by the following:

- A proportionate, risk-based approach to oversight by the government and the flexibility of a non-legislative approach to governing the evolution of the payments industry;
- A process of developing and implementing a national payments strategy that is contingent on effective input from stakeholders and buy-in to the process; for instance, the Council's attempt to eliminate cheques by 2018 was recently abandoned due to significant public and political backlash; and
- A Council with a board that is dominated by the banking industry, with only four independent directors, out of a total of 15 voting members, and a non-voting independent Chair; the independent directors have the power to veto decisions when voting as a block.

Following the debates around the abandonment of the cheque elimination initiative and in the context of a broader reform of the British regulatory framework for financial services including payments, the governance of the Payments Council is currently being reviewed by the Council and by the government.<sup>5</sup>

## ***European Union—Directive and self-government***

### ***Payment Services Directive***

The European Union (EU) has taken a somewhat prescriptive approach to regulating the payments industry. The Payment Services Directive (PSD) provides the legal framework within which all payments service providers in the EU operate.<sup>6</sup> The PSD has two main sections: 1) market (prudential) rules for payment service providers, and 2) business conduct rules.

The market rules describe the types of organizations that can provide payment services and set prudential standards for the various classes of service providers based on their risks. Providers can be authorized in any EU country and then “passport” their payment services across the EU without additional authorization requirements.

The business conduct rules specify transparency requirements for payment service providers in their dealings with customers (e.g., for charges, exchange rates and maximum execution times). They also stipulate a basic set of rights and obligations for both service providers and users (e.g., authorizing and executing transactions, liabilities for fraud, and refunds).

Two features are worth highlighting about the EU approach:

- It is highly useful in a market characterized by the presence of many independent states, because it provides regulatory certainty and common consumer protections, while promoting competition and efficiency.
- It defines a distinct payments industry and determines a holistic approach to public oversight.

### ***Single Euro Payments Area and European Payments Council***

European authorities and payments service providers do not rely exclusively on a legislative framework. Supporting both the regulatory framework under the PSD and EU efforts to fully

develop a single “domestic” market for payments in euro, banks and other financial institutions have taken actions to self-govern at the supra-national level.

In response to calls from European policy-makers for the payments industry to help realize the Single Euro Payments Area (SEPA), the banking industry established the European Payments Council (EPC) in June 2002. Its purpose is to support and promote the creation of the SEPA by developing the payment schemes and frameworks necessary to facilitate a single international zone for payments in euro.

Discussions with officials confirmed that the EPC is characterized by the following:

- Privately developed payments schemes complying with legislation. For example, the schemes have criteria that provide for non-discriminatory entry of new payments services providers, in line with Article 28 of the PSD promoting competition.
- SEPA uptake remains slow, in part because standards and products are not yet sufficiently harmonized or developed.
- Despite some efforts to develop and implement payments schemes for electronic credit and debit transfers, as well as for card payments, mobile payments and electronic billing applications, the bank-dominated EPC has not dedicated enough resources to integrating the perspectives of user stakeholders into its policy-making process.

### ***United States—The Electronic Payments Association***

The Automated Clearing House (ACH) is the largest electronic payments network in the United States, carrying federal government payroll and bill payments, as well as, increasingly, direct debits and image-converted cheques. It has two operators: 1) the public Federal Reserve Bank system (the Fed), and; 2) the Electronic Payments Network (EPN), a private entity owned by the ACH.

The Electronic Payments Association (known as NACHA) is the national association that makes the operating rules for the ACH system. NACHA members also collaborate to identify, develop and implement new payment products that leverage the ACH. NACHA is independent of government but cooperates closely with the Fed. Also, based on its status as an ACH operator, the Fed, along with the EPN, sits on the NACHA board as a non-voting advisor and participates in NACHA’s rule-making process.

Several features are worth highlighting about the NACHA approach:

- As use of the ACH network has grown (in volume and in participants), NACHA has broadened its membership base and restructured its board to allow broader representation on strategic decision making.
- The rules that determine user rights and responsibilities are determined in broad terms by government regulation. Many specific aspects of users’ payments experience are, however, determined through a process of private sector rule making that is more open than many other private payments networks owing to its need to facilitate participation in ACH by a diverse set of actors. NACHA’s members and affiliates—including financial institutions, payments firms, government agencies, corporate users and business associations—can join working groups to comment on, propose and help develop ACH rules.

- While NACHA has authority over only one payments network in the U.S. and its board and membership are still dominated by financial institutions, the collaborative nature of the organization, its open and consultative rule-making process, and its focus on innovation and education are all aspects that should be emulated in the Canadian context.

### ***Australia—Australian Payments and Clearing Association and the Australia Payments Forum***

The Australian Payments and Clearing Association (APCA) is the industry-owned payments association that develops, sets rules and standards for, and manages the domestic payments networks. While membership consists mainly of payment services providers and is therefore skewed toward financial institutions, APCA does have an associate membership category, which allows others to keep abreast of APCA activities.

APCA also maintains mechanisms to seek stakeholder input. In 2009–10, it restructured its various advisory councils and created the APCA Stakeholder Forum to leverage more expert resources and a larger number of stakeholders regarding decisions on its clearing systems.

The Australian Payments Forum is responsible for broader strategy for the payments system. It was created in 2010 by the APCA board and is supported by APCA. The Forum promotes industry-based and non-regulatory initiatives in Australia as a means of enhancing competition in card payments with minimal regulatory overlay. Membership includes non-APCA payment systems and community groups. The Forum considers the future direction of public policy in payments, focusing on ways to promote innovation and system evolution over the long term while ensuring healthy competition. Participants discuss complex issues such as the following:

- **Product innovation:** Tracking developments in product and network innovation—both in Australia and internationally—and seeking to identify ways to promote innovation, particularly at the network or system level.
- **Competition vs. collaboration:** Identifying areas where industry cooperation would help develop a better platform for efficient competition.

A feature worth highlighting in the Australian approach is that APCA focuses some of its efforts on promoting innovation, competition and efficiency in its payments systems, in particular, through its Low-Value Payments Roadmap and the development of a new, more open-access retail payments network.

The Australian Payments Forum has a short track record, so it is hard to assess its significance, but it seems to be a very positive self-governance development in the spirit of the model that the Task Force believes is needed in Canada.

### ***Lessons learned from other jurisdictions***

Our examination of payments governance models in other jurisdictions revealed that self-governance by stakeholders in the payments system is working in various forms around the world. It is also clear that governments take a keen interest in the payments system, but that oversight can take flexible or light-touch forms, where public–private collaboration or public

sector guidance of private actions and decision making can enable governments to pursue public policy objectives. This observation reinforced our views about an appropriate governance model for Canada. We conclude the following:

- It is possible and desirable to view the payments system as an industry separate and distinct from banking.
- Primary responsibility for finding optimal solutions to market challenges can be successfully placed in the hands of stakeholders, both users and providers. In other words, self-governance is feasible and appropriate.
- At the same time, and equally important, some form of public oversight must be provided and must be carried out in a manner that is principles-based and is aligned with the public interest.

### **Self-governance models in other industries**

In light of our interest in a self-governing model, the Governance Advisory Group examined models of governance in Canada where responsibility falls to the industry itself, such as in the medical, legal, accounting, auditing and securities industries. The securities and accounting industries provided particularly useful lessons (see Annex B3 for more details).

Governance of the securities industry in Canada is shared between the public and private sectors, a characteristic basic to the Task Force's vision of governance in the payments system. In assessing this model, we focused on the two major self-regulatory organizations (SROs) in the securities industry in Canada—the Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA)—and their relationship with one of the provincial securities regulators, the Ontario Securities Commission.<sup>7</sup>

The Task Force also looked at governance in the accounting industry. This is another industry that has a high need for public confidence and that has a governance model characterized by industry self-regulation balanced by public oversight.

### ***Securities industry regulation in Ontario***

The Ontario Securities Commission (OSC) is the regulatory body that oversees Ontario's capital markets. Accountable to the Ontario legislature through the Minister of Finance, it has legal authority to develop and enforce rules that help safeguard investors, deter misconduct and regulate capital market participants. A statutory process allows for public comments during the development of proposed rules and policies. All proposed rules are subject to review by the Ontario Minister of Finance. In its adjudicative function, the OSC carries out administrative proceedings relating to enforcement matters and regulatory policy issues, reviews adjudicative decisions of SROs, and reviews decisions made by OSC staff.

The *Securities Act* provides the OSC with the power to recognize SROs but does not specify what those SROs are.<sup>8</sup> In negotiating Recognition Orders with IIROC and the MFDA, the OSC worked with the other provincial securities regulators through a memorandum of understanding. This basically set the mandates and governance structures of the two organizations, determining under which accountability structures they operate and with what degree of independence.

The Governance Advisory Group noted that legislation can set general standards for the industry while providing the regulator with the flexibility to make rules that respond to market conditions, recognize industry-supported bodies and delegate to them the responsibility to self-govern and promote high standards in the industry. The OSC's role as an oversight body and adjudicator for SROs strikes a good balance between ensuring that the public interest is served and providing the industry with the opportunity to self-organize. This dovetails well with the Task Force's desire to ensure that, in the case of payments, the government has the tools to protect the public interest, while users and providers have incentives and a venue for collaboration.

### ***Public accounting self-regulation—Ontario and Canada***

Ontario's *Public Accounting Act, 2004*, created a new Public Accountants Council (PAC) for the province. The PAC is a corporate body, designed to ensure that public accounting in Ontario meets standards that protect the public interest and that are respected internationally. The PAC consists of 17 people—nine public representatives appointed by the Ontario government, and eight appointees of the three accounting bodies designated under the Act:

- The Certified General Accountants Association of Ontario,
- The Institute of Chartered Accountants of Ontario, and
- The Society of Management Accountants of Ontario.

The PAC develops new standards that comply with the Act and plays an oversight role with respect to the accounting bodies and their licensing of members. Each of the three designated bodies is an SRO that accredits and regulates its members, and its respective acts and bylaws incorporate the standards and regulations of the PAC and the *Public Accounting Act, 2004*. These bodies also develop regulations in accordance with the standards set by the PAC.

At the national level, the Accounting Standards Board (AcSB) is an independent body responsible for developing and establishing accounting and reporting standards in Canada for use in financial reporting by all entities outside of the public sector.<sup>9</sup> In addition, the Accounting Standards Oversight Council (AcSOC) was established in 2000 to serve the public interest by overseeing and providing input to the AcSB.

The governance framework in the accounting industry thus also demonstrates the benefit of mobilizing the expertise available in the private sector to determine standards and drive collaboration, while ensuring independent oversight for the public interest.

### **Self-regulation or self-governance?**

While certain elements of these models were highly instructive for our purposes, several characteristics seemed less relevant or somewhat limiting. For example, the securities and accounting industries tend to rely on a largely homogeneous group of service providers in whose collective interest it is to self-regulate. Professional reputation is a strong motivator in these types of models.

While reputation may matter to payment service providers too, the diversity of interests among providers and among stakeholders in general—the very characteristic that will drive change and innovation in the industry—is such that efforts to standardize on an assumption of homogeneity of service would stifle evolution rather than support it. Most importantly, self-regulatory models do not seem to provide adequate opportunities for users such as consumers, small businesses or merchants to participate as full members in the governance process.

The Task Force believes that the preferred model for the payments system is one that would favour solutions that are flexible and based on principles, objectives and standards rather than on prescriptive and limiting rules. The model would recognize the diverse interests of stakeholders and would be characterized by an inclusive approach to decision making. In other words, the Task Force favours a self-governance model over a self-regulatory model.<sup>10</sup>

## **Assessment of governance options**

Our examination of governance frameworks in other jurisdictions and industries uncovered no single model ideally suited to Canada's payments system. The Task Force therefore drew on elements from various models that align well with the unique payments space and, in essence, designed a new governance model.

The Task Force determined that an ideal governance model would feature the following characteristics:

1. **Full participation:** All stakeholders, both users and providers, should have the opportunity to participate as full members in the governance process.
2. **Mandatory application:** Certain stakeholders, defined as payment service providers under legislation, should be subject to the decisions reached within the governance model.
3. **Collaboration:** Dialogue and collaboration among stakeholders are essential. Dialogue allows issues that could otherwise lead to friction to be identified early as different perspectives are aired. Collaboration ensures that creative solutions aimed at achieving trust, access and good value—the objectives established for the payments system—are found to existing or emerging problems. It also increases the probability that opportunities for collective action, such as building common standards and infrastructure, will be identified and pursued.
4. **Oversight mechanism:** Although principles will provide guidance on the public interest considerations for the governance model, they will not necessarily resolve disputes or trade-offs in every situation. Some oversight mechanism is therefore needed: a) to ensure that the overall governance process does not stray from its broader objectives, and b) to serve as an “appeal” process in cases where reasonable disputes on the application of the principles fail to provide clear guidance on an optimal solution.

## **Developing the model through consultation**

In *The Way We Pay*, the Task Force proposed a governance framework for the Canadian payments system that reflected our thinking and work as of spring 2011. The proposed framework consisted of amended payments legislation and a public oversight body focused on policy and compliance, with a self-governing organization providing a forum for payments stakeholders to collaborate on

challenges and opportunities in the system. An entity to provide a basic payments infrastructure was also proposed.<sup>11</sup>

Since then, the Task Force has tested and developed the recommended governance framework and its supporting rationale through further research and engagement with experts and stakeholders. The written submissions of summer 2011 provided valuable feedback on the framework, guiding principles and goals in relation to public oversight, stakeholder collaboration and self-governance.

For example, we were reminded that market forces should be allowed to shape the evolution of the payments system and that government intervention in the form of regulation should only be pursued where markets have failed. Some stakeholders stressed the importance of a proportionate, risk-based approach to regulation and urged self-governance over government oversight whenever possible.<sup>12</sup> Overall, many stakeholders saw the benefits of an improved governance structure but did not want its implementation to lead to a more costly oversight mechanism that could detract from, rather than support, the evolution of the payments system in Canada.

**Box B3: C.D. Howe Institute submission (summer 2011)**

“Any regulations or governance changes follow only from the identification of a significant market failure as well as a demonstration that the proposed regulation or governance mechanism can address that market failure without imposing greater costs in its stead . . . . The Task Force stresses that any interventions should be minimal, clearly defined and limited, and ensure that all its recommendations not impose specific market structures, allocations of cost, decision-making processes or other organizational constraints on complex and evolving payment networks, but rather allow network operators and the markets in which they operate to determine these.”

The Task Force also relied on the valuable input of expert advisory groups to help in its assessment and development of the governance framework initially outlined in *The Way We Pay*. Their contributions included reviewing alternative governance models, assisting in fleshing out the details of the recommended framework, examining legislative and regulatory issues, and refining the guiding principles down to three: trust, access and good value (see *Policy Paper A*).

Together, these advisory groups set the broad parameters for self-governance in payments and provided the basis for the necessary legislative action (see *Policy Paper C*). The Task Force also drew from the insight of the Self-Governing Organization Working Group, which emerged in the spring of 2011 from the Scenarios Roundtable. This group considered the mandate, design and possible operational aspects of an industry-based self-governing body.

Indeed, the very collaboration that made the various working groups as effective as they were reinforces our conclusion that it is both possible and highly beneficial for stakeholders to work together in a complex and essential industry such as payments. Collaboration is at the heart of the Task Force’s recommendation regarding a governance framework for the payments industry.

## Recommended governance model

The governance model that the Task Force is recommending is a modest evolution from the one presented in *The Way We Pay* but now has a stronger foundation, supported by the research and outreach undertaken over the last year by the Task Force and the advisory groups, and especially by the valuable input of stakeholders and experts.

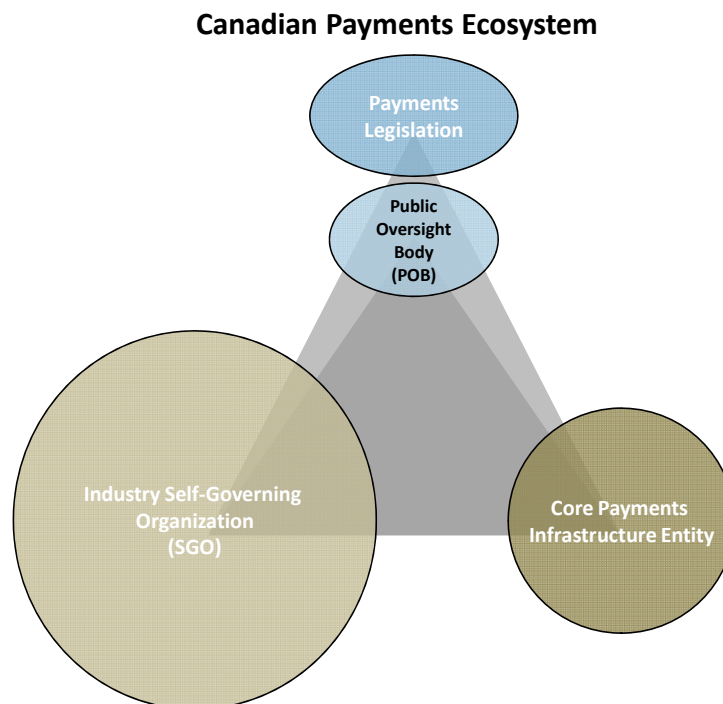
A new governance model for the payments system must address three primary responsibilities:

- **Protect the public interest:** Ensure that users' needs are fully considered in the development of strategy, standards and implementation plans.
- **Spearhead the development of the payments system:** Implement necessary changes and ensure that they achieve the desired outcomes (i.e., that they serve the good of all Canadians).
- **Correct problems:** Provide redress when industry behaviour no longer inspires trust, or when access, good value or competition and innovation are threatened.

To fulfil these responsibilities, the recommended governance model for the payments system has three key elements: 1) a self-governing organization, 2) a public oversight body, and 3) a core infrastructure entity. All of these bodies and their functions would be defined in new or amended payments legislation. The basic structure is shown in figure B1.

Figure B1: Recommended governance model

## Recommended Governance Framework



The three main components of the governance model are outlined below and are described in more detail in Annex B4.

## **1. Self-governing organization**

In the Task Force's proposed model, the balance of influence rests in the hands of a self-governing organization (SGO). The Task Force envisages the SGO as providing broad-based collaboration and strategic thinking for the industry as a whole. The SGO proposed for Canada would be significantly more inclusive than other payments bodies around the world. It would bring together banks, other financial institutions, payment card networks, acquirers, and new-entrant payments service providers, alongside a user community that includes consumers, merchants, small and medium enterprises, not-for-profit organizations, large corporations and governments.

Drawing on the ability of private industry to adapt and respond quickly, the SGO would be recognized as such by the public oversight body. The SGO would consist of two distinct groups of members defined by the legislation: 1) payments industry providers, for whom membership would be mandatory; and 2) users, who would be able to participate on a voluntary basis.

Through the use of dedicated working groups, the SGO would have the ability to set policies, standards and voluntary codes within the framework of the proposed principles-based payments legislation. Collectively, these might be similar in style to the recent *Code of Conduct for the Credit and Debit Card Industry in Canada*. Critical to effective collaboration within the SGO would be the implementation of mechanisms that would bring the voice of payments users to the collaboration process, and particularly to the dedicated working groups.

## **2. Public oversight body**

While freed of the detailed policy-making function, government would continue to be responsible for protecting the public interest. Under the ultimate direction of the Minister of Finance, this role would be fulfilled by a public oversight body (POB). This body would normally delegate much of its regulatory mandate to the SGO, while retaining the right and requirement to ratify strategies of the SGO and review its performance. The POB would protect the public interest by ensuring that the processes used to develop standards, rules, codes, etc. engage the right stakeholders. The POB would also provide a recourse mechanism for stakeholders who could not resolve important policy concerns within the SGO.

This model of a POB that recognizes and delegates authority to a self-governing industry body is inspired largely by securities regulation in Ontario (see the section on securities industry regulation in Ontario, page 13). The general relationship between the public and private sectors that this model advances is motivated by the Task Force's desire to provide a flexible, stakeholder-driven governance model. Vested with the overall public oversight function, and guided by principles-based legislation, the POB would assist the federal government in executing its mandate and would provide a holistic view that it is lacking now.

The POB would also retain directive powers over the SGO, as well as regulatory authority for the payments system. These powers would be used should industry behaviour (through the SGO) no longer inspire trust, allow access or provide good value, or if the payments industry did not ultimately display the necessary will to self-govern. Under a well-functioning self-governance model, this authority would be expected to remain in the background much of the time. The POB would nevertheless play a low-key but active role in consulting with and influencing the SGO to ensure that it acts in the public interest.

**Box B4: Providing a voice for users at the SGO**

In its recent efforts to promote a Working Group on Electronic Invoicing and Payments, as well as an Advisory Group on Consumer Issues, the Task Force recognized the tremendous benefits of not just enabling individuals from the user community to add their perspectives, but also of promoting dialogue between industry participants and users on the challenges that users face and how the industry can better serve its customers.

For the SGO to enable users to have a real voice, a critical mass must participate, unimpeded by funding considerations. As well, staff supporting the SGO would need to dedicate resources to researching and seeking ways to respond to user needs, especially in relation to the transition to digital payments. Users themselves need to be involved in establishing policies, codes of conduct and standards, as well as in the rollout of new technologies. One important role would be to help determine the needs of users for education or awareness.

### **3. Core infrastructure entity (reinvented CPA)**

The final pillar of the proposed governance model would be an entity to provide the necessary shared core payments infrastructure—a wholesale reinvention of the Canadian Payments Association. *Policy Paper D* explains the details and rationale for the changes to the CPA, but the governance aspects of the new approach to infrastructure need to be presented here. The POB would maintain oversight not only of the SGO but also, specifically, of the reinvented CPA, reflecting the key role of infrastructure in determining how the system can evolve.

As stressed in *Policy Paper D*, core infrastructure is an integral part of the payments system, limiting or enabling the products and services that suppliers can provide to users. The POB, therefore, must ensure that the services provided by the infrastructure entity meet the ongoing needs of users and suppliers in a way that balances efficiency with innovation. Some would argue that in the past our infrastructure has focused too much on cost-efficiency and not enough on innovation. As a result, our core infrastructure does not meet users' needs for information-rich and timely payments, and we are not on track to meet future expectations for immediate funds transfer. To remedy this situation, the infrastructure entity will need to move quickly to develop and execute an effective strategy. The role of the POB will be to ensure that the strategy of the infrastructure entity is consistent with the strategic direction for the industry, as developed by the SGO and ratified by the POB.

## Implementing the recommended model

### Required legislation

To underpin the model, the Task Force recommends the enactment of legislation that defines a discrete payments industry in which the public interest is broadly defined and identified through a principles-based approach.

As explained above, this legislation would also create a new POB and would reinvent the objects, governance, funding and business model of the CPA to enable it to serve as a revitalized payments infrastructure entity. *Policy Paper C* explains the proposed legislative reforms; *Policy Paper D* discusses policy rationales for change in the CPA.

While the proposed legislation would give a new POB the authority to recognize more than one SGO, the model outlined by the Task Force contemplates only a single SGO for the payments system. Indeed, the Task Force model reflects the need to build a degree of flexibility into the legislation to provide government with options for implementing the new governance model, depending on the level of required leadership from the public sector in relation to the private sector. These ideas are expanded upon in Annex B5.

### Paying for governance

The costs of the governing the Canadian payments system through the proposed SGO and POB would be passed on to users in the form of a very small fee applied to each transaction. Spread in this way over virtually all transactions on networks operating in Canada, these costs are expected to have a negligible impact on users.

Both CPA and private-network transactions would be subject to the fee. However, small networks below a minimum volume threshold (where collecting the user fee would be impractical) would be exempt. In principle, closed-loop and on-us transactions<sup>13</sup> would be subject to the user fee, but there could be practical challenges to resolve first. The POB would have the power to collect and apply the funds, but administration of the process could be delegated to the SGO.

To ensure that the governance costs remain reasonable, the POB would be accountable for its expenditures to Parliament through the Minister of Finance. The SGO would, in turn, be accountable to the POB for its budgeted expenditures.

Not all SGO expenditures would be funded through user fees. To provide a fairer allocation of costs, the members of working groups focused on specific aspects of the payments system would pay a fee for participation (with allowances for certain interests such as consumer groups). This model is used successfully in the U.S. to fund the working groups of NACHA (see page 11).

## **Addressing challenges**

The payments ecosystem should be enabled to evolve rapidly in the next decade and beyond in order to address the numerous challenges that will undoubtedly arise. Stakeholders—both users and providers—must be empowered to identify the issues and to work together to solve problems on an ongoing, proactive basis as swiftly and effectively as possible. In so doing, the POB will need to balance the interests of all stakeholders and seek solutions that are aligned with the three core principles we propose and thereby foster the evolution of an efficient payments system. Stakeholders are the ones with the most expertise to address these challenges, and it is in their best interest to do so in a way that goes beyond short-term, bottom-line considerations.

There will still be a need to ensure that the public interest is adequately protected, however. The POB will therefore need to nurture a broad, long-term, strategic vision for the evolution of the payments system, in cooperation with the SGO whenever possible. It will need to balance the views and interests of all stakeholders should they be unable to agree on acceptable solutions to emerging problems. The POB will need to ensure that all stakeholders' perspectives are adequately addressed through an inclusive process.

This new model must be flexible and adaptable, yet strong and resilient. It must be solutions-oriented and focused on overcoming obstacles that stand in the way of mutually beneficial evolution. We are counting on stakeholders to take up this challenge, but we recognize the requirement for an arbiter to provide a fail-safe mechanism; hence, our reliance on a stakeholder-based SGO, guided when necessary by a POB to strengthen the model and make it more trustworthy. As we have explained, we also see the need for a reinvented CPA to manage the infrastructure on which the payments system depends.

This structure therefore has checks and balances to ensure flexibility and reliance. It will require the three proposed bodies to work together, and it will challenge stakeholders to collaborate in the broader public interest while advancing their own agendas.

## **Examples of the model in action**

Three examples may help demonstrate how the SGO and POB might work out some of the problems currently facing all the stakeholders involved in the payments ecosystem, given the rapidly changing nature of payments and related technology, and the way in which the payments value chain is fragmenting and consolidating in new ways.

The proposed governance model can help shape the rules for future payments processes by promoting collaboration not only among traditional payments providers but also with new suppliers and participants, such as software and hardware manufacturers, accountants, regulators and law enforcement authorities. There is currently no effective forum in Canada for addressing these and numerous other issues that hobble the development of the payments system.

### ***Example 1: Helping consumers understand their risks***

As discussed in *Policy Paper A*, it is currently difficult for consumers and other stakeholders to sort out what rules determine liability when a fraudulent transaction occurs. To make the issue clear, we explained there in some detail the predicament faced by a fictitious average Canadian. Because she cannot properly assess the level of risk associated with various alternative payment mechanisms and determine whether their costs are appropriate, she cannot make an informed decision about which to use.

Retailers face a similar situation. Not only must they deal with bewildered consumers, but their own risk varies depending on whether a purchase is made using a debit or credit card, whether it is made online or in person, whether it is made by a consumer living in a jurisdiction where cashback provisions apply to online transactions, and so on. From the point of view of the card issuer, all this makes it harder for customer support staff to apply any redress mechanism.

In the spirit of fostering trust and delivering good value, the SGO could address this kind of issue by setting up a working group composed of representatives of issuers, networks, retailers, consumers, redress-mechanism providers, provincial and territorial regulators and other relevant stakeholders. This group would map out the current regulatory maze, identify the core issues for all concerned stakeholder groups, outline principles that could guide a reform in accordance with the policy principles that we propose, and draft a code of practice or other instrument to provide simpler, more coherent and more understandable rules for all. The POB could play a useful support role in providing research and in facilitating coordination with provincial and territorial regulators.

### ***Example 2: Helping small and medium enterprises migrate to electronic payments***

As outlined in *Policy Paper A* and in *Going Digital*, many small and medium enterprises (SMEs) still rely heavily on cheques and find the notion of migrating to electronic invoicing and payments daunting. They have good reason to be cautious. Successfully implementing this major transition will require effective collaboration among all the participants in the payments value chain.

Part of the challenge is that SMEs are offered conflicting advice and competing services by a highly diverse group of providers. Their accountants, financial institutions, major suppliers and principal customers all have different requirements and suggestions, and software providers offer a host of solutions that are often proprietary. Managers of SMEs clearly have the impression that those stakeholders never talk to each other.

The SGO would have to create a working group where all these players could bring together their expertise and agree on standards that would, for instance, address accountants' issues and support the development of software that would be affordable and easy to use for SMEs but that would also be seamlessly compatible with solutions deployed by their other providers or customers.

### ***Example 3: Preventing money laundering and other illicit transactions***

To trace the proceeds of crime, prevent money laundering and fight terrorism, Canada and other countries have implemented regulatory frameworks that require certain entities to identify customers, keep records and report on a range of financial transactions and payments. The cost and complexity associated with these rules are borne by all, as explored in *Policy Paper C*.

Financial institutions and other payment providers are directly impacted by these requirements, with customer identification requirements that are onerous particularly for transactions conducted online. Many have commented to the Task Force that regulators and policy-makers need to embrace new ways to identify and authenticate customers online. This would improve monitoring more generally as well as compliance with existing identification requirements while accommodating the development of new Internet-based products. It would also lessen the burden on individuals who have limited means of identification.

The Task Force believes that transitioning to digital payments, one of the foundations for the digital economy, requires public and private coordination to find innovative solutions, using emerging technologies to accomplish public policy goals regarding anti-money-laundering and anti-terrorism financing. At a practical level, ongoing public–private dialogue is needed. For example, a consultation paper issued by the Minister of Finance in December 2011 raised the issue of non-face-to-face identification measures and sought the views of the private sector regarding how best to update the requirements in this area.<sup>14</sup>

Given the emerging nature of digital identification and authentication, it may be necessary to create an SGO working group to understand the desired evolution and respond effectively to this request. This group would bring together regulators, law enforcement authorities, financial institutions and other stakeholders to explore new, more flexible approaches that are in line with similar efforts at the international level. The resulting proposals might then be implemented through policies set by regulators or, if required, through regulatory or legislative changes. The POB would most likely be involved in any such work, particularly in facilitating liaison with other federal players.

**Box B5: Credit and debit cards: A test case for governance of the Canadian payments system**

Over the past 18 months, the Task Force wrestled with issues related to credit and debit cards. We reviewed academic research and talked to regulators in Australia, New Zealand, the United Kingdom and the United States. We listened to more than 80 individual retailers across Canada and met numerous times with their associations. We exhaustively discussed the issues with credit and debit card networks, issuers and acquirers. Finally, we documented this review in our discussion paper *Credit and Debit Card Markets*.

The Task Force concluded that prescriptive regulation of credit and debit cards would not be effective. While the *Code of Conduct for the Credit and Debit Card Industry in Canada* has had a positive impact, it does not provide effective guidance on new and emerging technologies such as mobile wallets and proximity payments. These new technologies could have a much greater impact on retailers than credit and debit cards, because they represent much more fundamental challenges to existing business models. Given the rapid change in the payments system and the likelihood that such change will continue for at least a decade, we believe that control by market forces will be much more effective than regulation. Prescriptive regulation in this environment would stifle innovation and slow Canada's transition to the digital economy.

At the same time, we do not believe that, under the current regime, the networks, issuers and acquirers would have arrived at the Code of Conduct without the involvement of the Department of Finance. Had the recommended governance model been in place, the POB would have worked with the SGO to develop the code. If they had failed to arrive at a solution, the POB would have made recommendations to the Minister of Finance to address the unresolved issue. In a rapidly changing environment, there are likely to be many more situations warranting a code of conduct. While the principles outlined in *Policy Paper C* provide the foundation for developing these codes, the Task Force believes that it is important to have a mechanism to ensure that users' concerns are heard and that they are addressed effectively and to ensure resolution of most issues within the governance model itself.

This assessment of credit and debit card markets strengthened our view that an effective governance model is required to do the following:

- Protect the public interest, ensuring that users are considered in the development of strategy, standards and implementation plans.
- Monitor the implementation of the necessary changes to the payments system and ensure that they continue to achieve the desired outcomes.
- Provide redress, where necessary, when industry behaviour no longer inspires trust, allows access or provides good value.

At the same time, we believe that the expertise and knowledge necessary to manage the Canadian payments industry effectively is best found within the industry. The challenge will be to collaboratively address non-competitive, collective issues that naturally occur in this area of the payments system, given characteristics such as its nature as a two-sided market.

## **Implications for current players**

For the federal players currently involved in payments system policy making and oversight, and for the CPA, implementation of the Task Force's recommended governance model would have implications that need to be addressed.

### ***Minister of Finance***

Under the proposed governance model, the Minister of Finance would continue to be the public policy-maker and hold residual powers for payments matters. The Minister would sponsor amendments to the payments legislation to create the POB and reinvent the CPA. In retaining directive power over the POB, the Minister would also be the final recourse for disputes. The Minister would receive recommendations on policy making with respect to governance, legislation and regulation of the payments system from an advisory committee that includes the POB and the Bank of Canada. Endorsement and encouragement by the Minister would be key to ensuring industry willingness to create the SGO.

### ***Bank of Canada***

The Bank of Canada has legal authority under the *Payment Clearing and Settlement Act* (PCSA) to designate and oversee payments and other clearing and settlement systems that have the potential to pose systemic risk to the Canadian financial system, provided that the Minister of Finance concurs. It is in the public interest for the Bank to do so. Its main focus is on the designated systems, including the Large Value Transfer System (LVTS), CDSX and the CLS Bank, though it periodically surveys other networks for potential systemic impacts.

The Task Force recommends that the operations of the POB and the SGO not supplant or interfere with this oversight function, although there is scope for integrating the Bank of Canada's expertise into the new governance model. The Task Force recommends that the Bank sit on the POB and have an observer role with the CPA board. By sitting on the POB, the Bank of Canada could ensure that SGO policies not undermine its oversight of the LVTS and other designated systems. Moreover, an observer role with the CPA board would give the Bank direct insight into major strategic and operating decisions, which would assist it in overseeing the CPA for systemic purposes.

### ***Privacy Commissioner and Competition Bureau***

While the Task Force does not recommend that their mandates be changed, under the new arrangements, the Privacy Commissioner and the Competition Bureau would have opportunities to become more proactive regarding payments. They are well positioned to tap into POB knowledge of emerging payments issues in order to identify real or potential policy challenges in the realm of privacy and competition, to bring their own concerns to the POB's attention when appropriate, and to seek early remedies.

For example, the Office of the Privacy Commissioner was an active participant in the Digital Identification and Authentication working group, ensuring that the impact on individual privacy and the link with developing amendments to provincial privacy legislation were fully considered.

### ***Financial Consumer Agency of Canada***

The Financial Consumer Agency of Canada (FCAC) is responsible for ensuring that the market conduct of federally regulated financial institutions and payment card networks complies with federal legislation and regulations. It has legal authority, under federal financial institution statutes and the *Payment Card Networks Act* (PCNA), to enforce legislation and monitor the compliance of regulated providers. As well, the FCAC monitors the compliance of these providers with consumer-related public commitments, including the *Code of Conduct for the Credit and Debit Card Industry in Canada*.

The oversight scope of the FCAC regarding payments poses a challenge. The Agency is responsible for federally regulated financial institutions and for payment card networks, but not for other payments service providers. This creates a real potential for overlaps and gaps concerning SGO codes of conduct or user protection policies. Were current arrangements to continue, the FCAC would oversee these rules for federally regulated financial institutions and card networks, but not for other SGO members. The Task Force believes that the SGO should take on the role of monitoring and addressing complaints about the actions of its members in relation to its own codes and policies.

Government would need to determine an appropriate separation of responsibility for compliance enforcement between the FCAC and the SGO. To this end, the Task Force proposes changes to the FCAC mandate, including the reassignment of its responsibilities for monitoring payments-related codes of conduct or other provisions, including the *Code of Conduct for the Credit and Debit Card Industry in Canada*. These would be transferred to the POB for delegation to the SGO.

### ***Canadian Payments Association***

The CPA provides a starting point for transforming the governance of the payments system. Originally created in legislation, it is currently the only body focused on the operations and governance of the shared payments system. To suit the proposed governance model, it would need to be reformed, ceding some of its existing policy-making responsibilities for the payments system to the POB and SGO,<sup>15</sup> which would set holistic strategies, as well as industry policies and standards. A reinvented CPA would, however, continue to develop technical rules, policies and strategies to enable payments functionality and interoperability, domestically and internationally, to meet users' needs.

#### Box B6: Implementation issues

The Task Force has identified a number of implementation issues that will need to be addressed regarding collaboration on governance between the public and private sectors:

- **Establishing a coalition of the willing in the private sector to create a self-governing organization (SGO) and participate constructively in it.** While many stakeholders can recognize the benefits of collaboration on specific issues, self-governance on a broad scale is harder to envision and implement. Our experience has revealed a healthy amount of curiosity about the concept of payments system self-governance, but not a strong will on the part of many stakeholders to move forward. They want a careful assessment of options for doing so, as well as a good sense of the political landscape and the government's response to our final report. They are particularly interested in its readiness to put in place the requisite legislation compelling membership in the SGO. There is also no guarantee that industry will align with the proposal, and so far no other country has sought to instil this degree of industry involvement in the governance of the payments system. Implementing the proposed approach would therefore represent a considerable vote of confidence in the collaborative potential of stakeholders who have not always been able to cooperate.
- **Assessing the appropriate issues for stakeholder self-governance and public interest oversight and intervention.** As outlined in *Going Digital*, we are encouraged that payments stakeholders are beginning to discuss areas of potential collaboration coming out of the Task Force's various working groups. However, under the *Competition Act*, there could be limitations on private sector cooperation. Those limitations would make it difficult for industry competitors to legally discuss and agree on competition issues addressed, for example, by the federal government in the *Code of Conduct for the Credit and Debit Card Industry in Canada*. Issues for discussion could include the ban on competing domestic applications for debit cards. On the other hand, if there had been a concerted effort in the first place by industry and user stakeholders to agree on remedies in the card and acquiring sectors, the required scope of the code might have been considerably reduced. Therefore, care needs to be taken in setting the legal structure and priorities of the SGO to maximize the freedom of would-be competitors to self-govern on public interest issues.
- **Developing mechanisms or processes for the transition to a new governance model.** The full transition to new legislation, along with the subsequent creation of a POB, an SGO and a reformed CPA will require some time. The transition will require greater attention and resources from the federal government over the short to medium term than when a steady-state situation is eventually reached. This factor should be taken into account in designing the organizational form of a public oversight body and any transitional organizations.

Public policy-makers and payments system stakeholders will need to undertake dialogue on two matters: 1) the readiness for self-governance of the payments industry and user stakeholders; and 2) the level, focus and objectives of leadership required from the public and private sectors.

## Conclusions and next steps

Payments, and the industry that supports them, are intrinsic to the Canadian economy. All Canadians encounter issues relating to the payments system. The research and analysis conducted by the Task Force has demonstrated that a modern and effective governance model is needed and that government will be key to its implementation. This model should not rely on prescriptive rules that could hamper innovation and become part of the problem rather than part of the solution. Instead, the Task Force recommends the following:

- That government begin developing the legislation necessary to define the payments industry and implementing a governance model as outlined in this paper, including a public oversight body with the power to recognize and delegate authority to a self-governing organization. (See *Policy Paper C* for details on the legislative implications of our governance model.)
- That stakeholders begin working in earnest to create an entity that will become a self-governing organization under the new governance model. This new organization would take over much of the work begun by the Task Force on such issues as electronic invoicing and payments, mobile payments and digital identification and authentication. In developing its operational structure, the organization could take guidance from the many working and advisory groups brought together by the Task Force to address issues affecting consumers, merchants, small and medium enterprises, large corporations and governments.

Although the proposed model has its roots in legislation, responsibility basically falls to the private sector, in consultation with the oversight body, to develop the self-governance vehicle needed to achieve effective collaboration among stakeholders. While the legislation may take time, the process of building an SGO can begin right away and we urge industry, for its own good, to take the lead in beginning this process.

## Annex B1: Current governance framework for payments

In payments, governance can be thought of as the institutions, rules and relationships that shape the nature of the system and the actions of its participants. Institutions include the federal and provincial governments and public-purpose bodies like the Bank of Canada, the Canadian Payments Association (CPA), and international players such as the Society for Worldwide Interbank Financial Telecommunication (SWIFT).

The payments system operates under legislation of both general and specific application, privately developed network rules, and voluntary codes of conduct that determine the form and process of payments, clearing and settlement and that spell out obligations toward users and user-protection mechanisms. Finally, the informal interactions among governments, industry and user stakeholders, and payment network participants help shape the changing nature of the Canadian payments system over time.

### The current framework

The current governance framework for payments in Canada is influenced by a number of entities, some private and some public. The legislative landscape is centred on financial institutions. Deposit-taking financial institutions are the primary holders and movers of Canadians' money; some payments-related legislation is contained in federally regulated financial institution statutes; and the CPA, which owns and operates the core payments clearing and settlement systems for Canada, is dominated by the large deposit-taking financial institutions.

This is not surprising. Canada has a highly developed, robust and trusted financial system, which has as its core a handful of long-standing banks. Canadians trust deposit-taking financial institutions with their money; it is natural that we have relied on them to facilitate our payments. The financial institutions have responded by developing solutions and building common payments networks that have enabled commerce in Canada.

For its part, the federal government seeks to protect the public interest with respect to payments through a multi-pronged approach.

At the apex of the federal oversight and policy-making structure is the Minister of Finance. The Minister has historically been viewed as the person responsible for financial sector regulatory policy, including payments. The Minister of Finance has therefore played an important role in shaping the evolution of payments-related provisions and oversight. As more non-financial institutional players have entered the market, government has increasingly turned to payments-specific legislation to accomplish public policy objectives (e.g., the *Canadian Payments Act* and the *Payment Card Networks Act*). The Minister can also use moral suasion through alternative policy tools (e.g., the *Code of Conduct for the Credit and Debit Card Industry in Canada*); these tools can be backed up by legislation should the need arise to regulate formally.

The Bank of Canada has legal authority under the *Payment Clearing and Settlement Act* to designate and oversee clearing and settlement systems that could pose systemic risks to the

Canadian financial system, provided that the Minister of Finance agrees that it is in the public interest to do so. The Bank's primary focus is on the Large Value Transfer System (LVTS) and other designated systems, although it is constantly assessing other networks for potential systemic impacts.

The Financial Consumer Agency of Canada (FCAC) regulates the market conduct of federally regulated financial institutions and payment card networks. Under federal financial institution statutes and under the *Payment Card Networks Act*, it has legal authority to enforce legislation and monitor companies' compliance with consumer-related public commitments, including the *Code of Conduct for the Credit and Debit Card Industry in Canada*.

Finally, payments industry players are subject to acts of general application, including those enforced by the Competition Bureau and by the Privacy Commissioner.

Public oversight of payments is also shared with provincial authorities in limited areas. Various provinces have implemented consumer protection laws or regulations; those that are payments-specific focus mostly on stored-value gift cards.<sup>16</sup>

#### **Box B7: The interests and role of government in payments**

An essential role of any legitimate government is to protect the public interest, which is not always easy to determine. In payments, the public interest includes ensuring user protection, access, competition, accountability and transparency, system stability and the system's effects on the broader financial system. It is also reasonable to contend that a government should seek to ensure that it has the capacity to assess the public interest on an ongoing basis, to adjust policies and to employ oversight levers to ensure that the public interest is maintained.

The private sector develops rules, policies and standards on how to operate, which affect payment service providers and users and which form an important part of the governance framework. In fact, rules made by private entities can impact the daily payment experiences of Canadian consumers and businesses even more than the structure and actions of public oversight do. These rules include the recourse options for reversing erroneously routed payments or payments linked to the purchase of an unsatisfactory good or service (i.e., "charge backs") and options relating to the finality of payments (i.e., when the payee can be sure the payment is not reversible). Private sector rules can also determine access to payment networks, affecting the industry's competitive landscape. Therefore, the decisions of private entities can affect whether the payments system operates in the public interest.

Owing to public policy considerations, including the desire to ensure user protection and to spur healthy competition in the payments industry, the federal government oversees or influences some aspects of private sector rule making in Canada. For instance, the CPA sets a number of bylaws and rules that bind participants in its clearing and settlements systems, such as the Automated Clearing Settlement System (ACSS) and the LVTS. The CPA also sets format standards for the messages sent on CPA networks and promotes the international interoperability of payments. Under the *Canadian Payments Act*, bylaws are subject to approval by the federal

Minister of Finance, who also has the authority to review and disallow new CPA rules and amendments to existing rules.

Rules for the provision of services on the Interac Inter-Member Network are determined by the Interac Association alone, but many of its innovative products also require new CPA rules, which are subject to the CPA's stakeholder consultation mechanism and to review by the Minister of Finance. As well, a Consent Order, first imposed by the Competition Tribunal on the Interac Association in 1996, established a foundational direction for the rules on access to the Interac network, for instance, allowing non-financial institution entities to connect in with private-label automated banking machines (ABMs) for cash dispensing.

While a significant number of Canadian retail payments flow through them, other private sector payment networks' rules are not subject to public oversight or influence. For their part, the card networks—including Visa, MasterCard, Amex, and Blackhawk (which offers closed-loop network services for gift cards)—all determine network rules internally, including those that allow for innovations in their product offerings, and are free to choose whether or not to employ user-consultation mechanisms. Newer entrants to the Canadian payments system, including firms such as ZoomPass and PayPal, also determine their network rules outside of public oversight. The regulated deposit-taking Canadian financial institutions also determine their processes and user rights policies independently (such as finality of payment) for clearing payments between the accounts of their own customers (termed “on-us” payments).

#### **Box B8: Past Canadian government interventions in payments**

A challenge for payments system governance is how to deal with the structural nature of networks—preserving the strong benefits for participants and for the broader economy of collaboration in order to build networks, and allowing network owners to earn a fair return on their investment, while preventing or minimizing incentives for abuse by those that control the networks. This challenge is long-standing, and past Government of Canada actions to address it are instructive.

The Canadian Payments Association (CPA) was created in December 1980 as a mechanism for addressing a key federal government concern; “namely, the need for equitable competition in the provision of payments services in a rapidly changing environment requiring major investments in computers and telecommunications devices.” Among other changes from the body that was housed within the Canadian Bankers Association, the CPA's board of directors is chaired by a Bank of Canada representative, a small minority of its seats are reserved for independent directors, and its rules are subject to review by the Minister of Finance to ensure that public interest considerations are addressed.

In 1996, the Competition Bureau supported a Consent Order with the founding “charter” members of Interac, based on its concerns that Interac members were abusing their dominant position and restricting access to the ABM and retail point-of-sale network to a few players (CPA members), discouraging competition through the board decision-making processes and imposing unduly high fees on qualified new entrants. An amended Consent Order remains in force today. It is a key factor

in the maintenance of Interac as a low-cost pillar of the Canadian payments system on which most Canadians rely and from which most benefit.

While the Visa and MasterCard payments schemes were founded as associations of financial institutions, some argue that their movement to for-profit corporations has increased the incentive to boost transaction income at the expense of some users of the networks. The Competition Bureau has recently turned its attention to the rules governing the credit card networks, arguing that some key provisions contravene the *Competition Act*. The *Code of Conduct for the Credit and Debit Card Industry in Canada*, issued by the Minister of Finance in 2010, also seeks to better balance the power of providers and merchant users of card payment services by, among other things, increasing transparency and promoting fair business practices in the industry.

The Canadian payments system is both constantly evolving and, at the same time, presenting recurring governance challenges related to protecting systemic safety and soundness, providing user access and protection, and promoting competition and collaboration that can boost innovation and efficiency. Healthy competition is especially difficult to achieve because the challenges stem from the nature of payments and from situational factors in Canada.<sup>17</sup>

### **Assessing governance of the Canadian payments system**

The Task Force believes that the present federal legislative framework and payments oversight structure has notable shortcomings, including gaps in the suite of legislation and policy tools.

The Bank of Canada has a clear remit and the tools needed for ensuring the safety and soundness of systemically important payment systems through global best practices. For the Minister of Finance, however, intervention in the payments system is less straightforward. Although the government has in the past helped shape the evolution of the payments system (e.g., by working with the Bank of Canada to create the CPA and to encourage development of the LVTS), its policy interventions have tended to be reactive, undertaken in response to stakeholder complaints. As a result, the present regime leaves many of the rights of the public and the responsibilities of service providers to be defined by standard form contracts and voluntary industry codes. Inefficiencies and suboptimal situations can thus persist for extended periods.

As previously mentioned, payments networks are governed by rules that are most often set by private actors. In the Canadian payments system, legislation is the default tool used to influence any kind of private rule making. For instance, the *Personal Information Protection and Electronic Documents Act* (PIPEDA) and the *Competition Act* either influence the drafting of rules or can be used by authorities to force a rewrite of private rules that are inconsistent with those acts.

For the federal government, the essential challenge in payments system governance is that many key aspects of the public interest are not spelled out in legislation, and direct policy tools for protecting the public interest are limited. The Minister of Finance can intervene in a reactive, ad hoc fashion and has some oversight tools to directly influence a handful of important players such as the CPA (through approval of bylaws, disallowance of rules or use of directive power).

There is, however, no comprehensive oversight regime for the payments industry, nor is there even a clear definition of the industry. Likewise, the sharing of responsibility for oversight among a number of federal agencies makes it more difficult for the government to take a holistic and strategic view of the public interest.

Clearly spelling out principles and objectives in a legislative framework would provide the transparency necessary for a largely self-governed payments industry. In implementing the proposed governance framework, the government would then have in place a holistic, proactive public oversight mechanism to address situations in which the industry fails to resolve issues in a manner consistent with the public interest.

In the view of the Task Force, the recent introduction of the *Payment Card Networks Act* and the *Code of Conduct for the Credit and Debit Card Industry in Canada* reveals federal government recognition that traditional legislative and policy tools for protecting the public interest in the payments system are inadequate.

These factors are set against a payments environment where technological advances globally, and new entrants domestically, are increasing the complexity and speed of change in the payments system. In response to this reality, the federal government must be in a position to think and act strategically, consistently and proactively in order to best determine and implement policies to safeguard the public interest.

## Annex B2: Self-governance—International comparators

This document summarizes the key findings from the Task Force’s review of payments governance in other jurisdictions. One theme of particular interest was the role of collaboration among the various stakeholders. Another was how other jurisdictions deal with the challenges of oversight and strategic management of the payments system.

The review focused on governance models implemented in the United Kingdom, the European Union, the United States and Australia. Each jurisdiction has a body that serves to coordinate the interests of stakeholders, although in some cases it is dominated by incumbent players.

Table B1 provides an overview of some of the key characteristics of the regimes we looked at.

**Table B1: Payments industry self-governance—International comparators**

	Canada	U.K.	E.U.	Australia	U.S.
<b>Industry body</b>	Canadian Payments Association	Payments Council (PC)	European Payments Council	Australian Payments and Clearing Association	Electronic Payments Association (NACHA) (for Automated Clearing House [ACH] only)
<b>Government oversight</b>	Department of Finance	U.K. Treasury Office of Fair Trading (OFT)	The European Central Bank sits on all working groups. The European Commission (EC) is also involved.	None	The Federal Reserve Bank advises the board (as an ACH operator) and sits on rules committees.
<b>Role (and focus)</b>	Payments strategies, rules and systems operation (policy and technical)	Industry initiatives, systems rules (policy and technical)	Single Euro Payments Area (SEPA) payment schemes (policy and technical)	Rules and payments strategies (policy and technical)	Rules for e-payments; new product development (technical, strategic)
<b>Created when?/ Legal status?/ By whom?</b>	1980/statute ( <i>Canadian Payments Act</i> )	2007/ non-statutory/ OFT’s payments task force	2002/ non-statutory/ members	1992/ non-statutory/ members	1973/non-statutory/ big banks and regional ACH associations
<b>Mandate set by</b>	Legislation	OFT	Members, in collaboration with the EC	Members	Members

	Canada	U.K.	E.U.	Australia	U.S.
<b>Governance structure set by</b>	Legislation	Negotiated between industry, OFT and Treasury	Members	Members	Members
<b>Self-governing?</b>	Yes, but rules are subject to review and disapproval by Minister of Finance	Yes, but OFT reviews PC progress against its mandate	Yes, but ensures that its SEPA schemes comply with EC directives	Yes	Yes, but ensures that operational rules are consistent with federal regulations for NACHA member institutions
<b>Member composition (membership class, if any)</b>	Banks, centrals, trust and loan companies, securities dealers, other financial institutions	- Banks (full) - Payments processors, technology firms and consultants (associates)	Banks and banking associations	- Direct clearing banks (owner) - Smaller banks and credit unions, large corporations, etc. (participants) - Other interested parties (associates)	- Any deposit-taking financial institution insured by the Federal Deposit Insurance Corporation (direct) - Small and foreign banks, payments processors, technology firms, large corporations and consultants (affiliate)

### U.K.—Payments Council and payments system governance

Spurred by the Cruikshank Report on banking and payments, the U.K. Treasury gave the Office of Fair Trading (OFT)<sup>18</sup> a four-year expanded mandate in the early 2000s to look at payments system issues. The OFT established a Payment Systems Task Force in 2003, which was chaired by the OFT and which brought together banking industry, payments industry, retail, consumer and business representatives.<sup>19</sup> The task force focused on competition, efficiency incentives and network effects of existing payment mechanisms (with consumer issues being of secondary importance).

After two and a half years, the task force managed to open up the governance and membership of the bank-controlled LINK ABM scheme; reform governance of the interbank clearing systems by ensuring the establishment of a stakeholder advisory group; and encourage the industry to speed up the processing of electronic personal and business payments (clearing in less than one day, down from about three days), as well as cheque clearing, through the creation of a new national payments network—the Faster Payments initiative.

#### *U.K. Payments Council*

The OFT task force also recognized the need for a more permanent organization to promote good governance and innovation in payments. It recommended to the U.K. Treasury that a private sector-led Payments Council be struck to be responsible for ensuring the overall integrity

and operational efficiency of non-card payments systems. The Treasury welcomed the formation of the Council in spring 2007, after negotiation by OFT task force members.

While the Payments Council is independent, the OFT set its original mandate and acts as a watchdog by undertaking reviews of its performance every two years, to which the Council is expected to respond. The OFT set three key objectives for the Council:

- To lead the future development of cooperative payment services in the United Kingdom;
- To ensure that the payment system is open and accountable; and
- To ensure the operational efficiency, effectiveness and integrity of payment services in the United Kingdom.

#### ***Payments Council characteristics***

- Industry-funded and dominated
- Board of directors: 16-member board consisting of one non-voting independent chair, selected through an open and collaborative process, and 15 voting board members:
  - Four independent directors, selected through an open process focused on finding expertise in large and small business, consumer and regulatory issues<sup>20</sup>
  - Eleven industry directors appointed by full members
- Full members with over 5% of U.K. payment volumes have the right to appoint a senior individual from their organization to be an industry director.
- Full members with 5% or less of U.K. payment volumes organize in constituencies and nominate/vote on their industry director.
  - The large commercial banks hold majority board representation and voting power; however, the four independent directors, when voting together, hold a blocking minority.
  - The board develops and maintains the Strategic and Corporate Plan, in consultation with stakeholders. It also appoints the chief executive of the Payments Council.
- Membership structure is wider than the previous iteration of the national banking/ payments association, but does not include consumer and merchant associations:
  - Full members must be payment service providers in the U.K. and have qualifying payment volumes.<sup>21</sup>
  - Associate members can be any organization with an interest in the payments industry. Associate members access a variety of payments-related information, research and contacts with full members but have a limited voice in the Council.
  - The Bank of England is a full member as of right.
- Stakeholder groups
  - The board can set up subgroups for the purpose of agreeing on policy issues that may affect the Council and its members. The subgroups are funded by the Council and may be subject to the direction of the board.

- These subgroups or forums are employed to test policies and initiatives with non-members. The board takes this input into consideration but is not bound by it.
- Existing payment systems remain responsible for day-to-day management, but all (aside from the card networks) are bound by decisions of the Council.

## EU—SEPA-related bodies

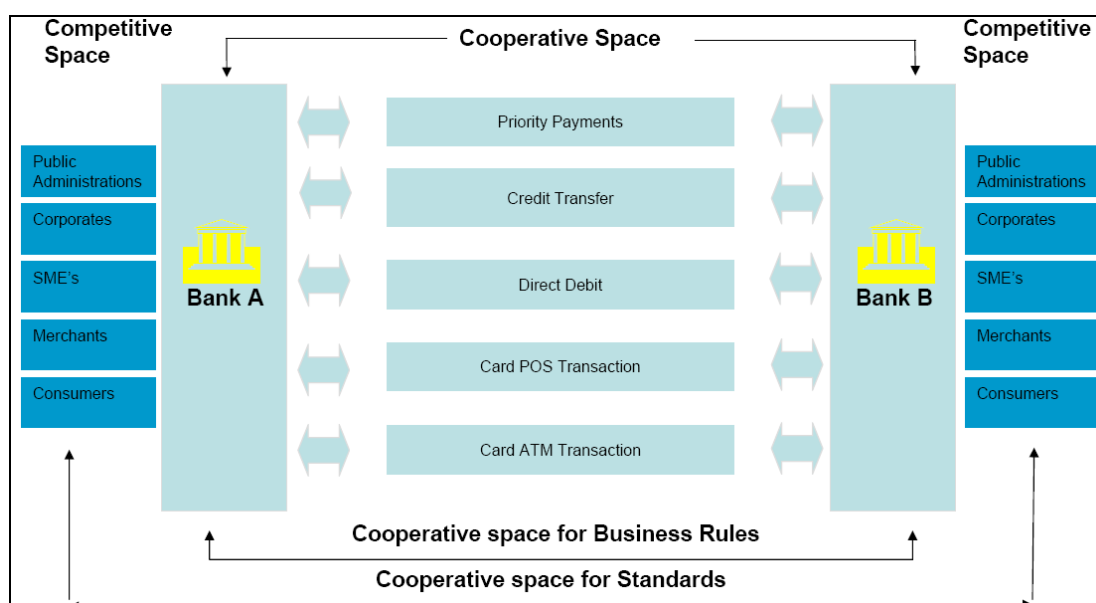
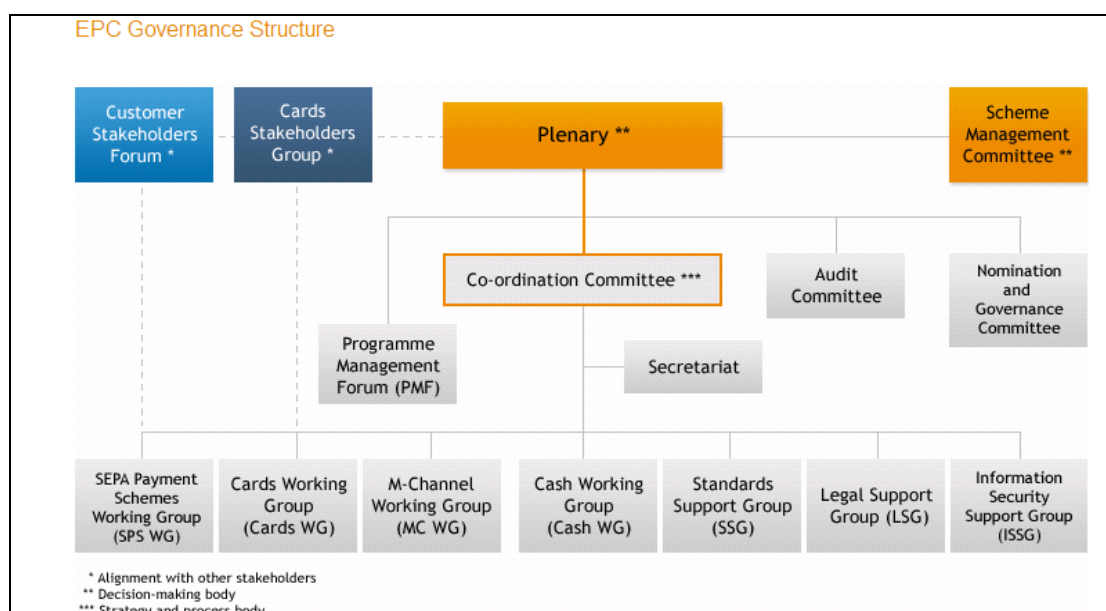
The European experience is unique in that policy-makers and payments stakeholders are working together to build a cross-border payments infrastructure where all payments are considered domestic—the Single Euro Payments Area (SEPA). This singular goal has many sub-themes (e.g., the need to agree on schemes for varying payment types, including mobile payments), but it is a strong organizing force that has led to a cooperative relationship between the big payments players—primarily commercial banks—and European government officials.

### *European Payments Council (EPC)*

In response to calls from the European Commission (EC) for the payments industry to help realize SEPA, the EPC was established in June 2002 by the industry. Its purpose is to support and promote the creation of SEPA by developing the payment schemes and frameworks necessary to facilitate a single international zone for payments in euro. The EPC defines common positions for the cooperative space of payment services; provides strategic guidance for standardization; formulates rules, best practices and standards; and supports and monitors implementation of decisions taken (see figure B3).

#### *EPC characteristics*

- Bank-funded and dominated: 74 members representing banks, banking communities (i.e., national bank associations) and some payment institutions (see figure B3).
- More than 300 professionals from 32 countries are directly engaged in the EPC's work program, representing all sizes and sectors of the banking industry within Europe.
- Work is focused on developing schemes (rule books) for effecting electronic direct credit and debit transfers, payment card transactions, mobile payments and e-billing throughout the eurozone. The EPC has a number of working groups to pursue industry-wide standards (see the bottom line of figure B4).
- The SEPA schemes have criteria that provide for non-discriminatory entry of new payments services providers, in line with Article 28 of the European Union's Payment Services Directive (PSD).
  - Given that all EPC members are bound by the PSD as implemented in their home jurisdiction's legislation, the EPC voluntarily undertook to ensure compliance of its schemes with the PSD.
  - The EPC has a Customer Stakeholder Forum, which was established in 2007 and which includes large customers and business groups interested in straight-through electronic processing of SEPA payments. The Forum is primarily used to engage corporate (and possibly government) customers on how to better leverage SEPA payments products being offered by EPC member banks.

Figure B2: European Payments Council—Competitive and cooperative space<sup>22</sup>Figure B3: EPC governance structure<sup>23</sup>

### SEPA Council

The council was created by European Commission (EC) and European Central Bank (ECB) officials in June 2010 as a bid to ensure that all key stakeholders are involved in the ongoing implementation of the SEPA at the retail level. The SEPA Council will meet twice a year for an initial period of three years and comprises EC and ECB officials, as well as representatives of providers and users of payment services.

The Council's main role is to facilitate the sharing of information on implementation priorities and challenges and to provide a forum for public–private voluntary cooperation. It is co-chaired by the EC and ECB and is composed of the following:

- 5 representatives from the user side of the market (consumers, retailers, businesses and national authorities),
- 5 representatives from the supplier side (EPC, cooperative banks, saving banks, commercial banks and payment institutions), and
- 4 national central bank board members (representing the Eurosystem).

## Australia—APCA

### *Australian Payments and Clearing Association (APCA)*

APCA is the industry-owned payments association that develops, sets rules and standards for, and designs the domestic payments networks in Australia. It is therefore similar in mandate to the CPA. It also focuses some efforts on promoting innovation, competition and efficiency at the technical level, in particular, through its Low-Value Payments Roadmap and through the development of new, open-access retail payments networks (e.g., the COIN).

#### *APCA characteristics*

- Membership
  - Owner membership (open to direct clearers), which confers rights relating to the governance of the company (e.g., appointing directors and voting at meetings);
  - Participating membership (open to participants in APCA systems), which confers rights of participation and governance in APCA clearing systems;
  - Associate membership (open to all interested parties), which allows one to be kept abreast of APCA activities; and
  - APCA's constitution also provides for new categories of participating membership if required (i.e., if technology gave rise to a new and different type of payment instrument).
- Stakeholder input
  - An Advisory Council exists for the Consumer Electronic Clearing System. Membership is drawn from non-participants, and its purpose is to enable the provision of advice and input to management committees on payments system issues affecting the wider community.
  - APCA also has a Stakeholder Forum that leverages expert resources and a large number of stakeholders regarding decisions on its other clearing systems.

### ***Australian Payments Forum***

The APCA board also recently created the Australian Payments Forum. Its membership includes non-APCA payment systems and community groups. The Forum considers the future direction of public policy in payments, focusing on ways to promote innovation and system evolution over the long term while ensuring healthy competition. Participants discuss complex issues such as the following:

- Product innovation: Tracking developments in product and network innovation both in Australia and internationally, and seeking to identify ways to promote innovation, particularly at the network or system level; and
- Competition vs. collaboration: Identifying areas where industry cooperation would help develop a better platform for efficient competition.

### **U.S.—E-payments governance under NACHA**

The Automated Clearing House (ACH) is the largest electronic payments network in the U.S., with federal government payments, public and private payroll, and bill payments making up the majority of payment items. The Electronic Payments Association (NACHA) is the national association that makes the operating rules for the ACH. Members also collaborate to develop new payment products that leverage the ACH; this work occurs under the Advanced Payment Solutions banner (see figure B5).

NACHA formed in 1974 when a number of regional ACH associations and the American Bankers Association decided to create a national ACH rule-making and trade-association body. It is independent of government but cooperates closely with the Federal Reserve Bank system.

Originally, NACHA membership was limited to the numerous regional ACH associations and a few large national banks (e.g., Citibank, Bank of America), which provided correspondent payments services for the smaller financial institutions. Each ACH association and bank member had a seat on the board, for total membership of about 35. Board discussions tended to be operationally focused, and all rules were voted on at the board.

Given the broad base of financial institutions, payments companies, corporate entities and individuals that began to use the ACH, in 2000, NACHA undertook a one-year process to open up its membership base and rule-making process. The rule-making process is now separate from the board elections processes. NACHA reformed its board structure and election rules, moving from directly appointed board members to a representative model with elected members. A new Rules and Operations Committee was struck, and voting has been opened up to all NACHA members and members of regional ACH networks affiliated with NACHA.

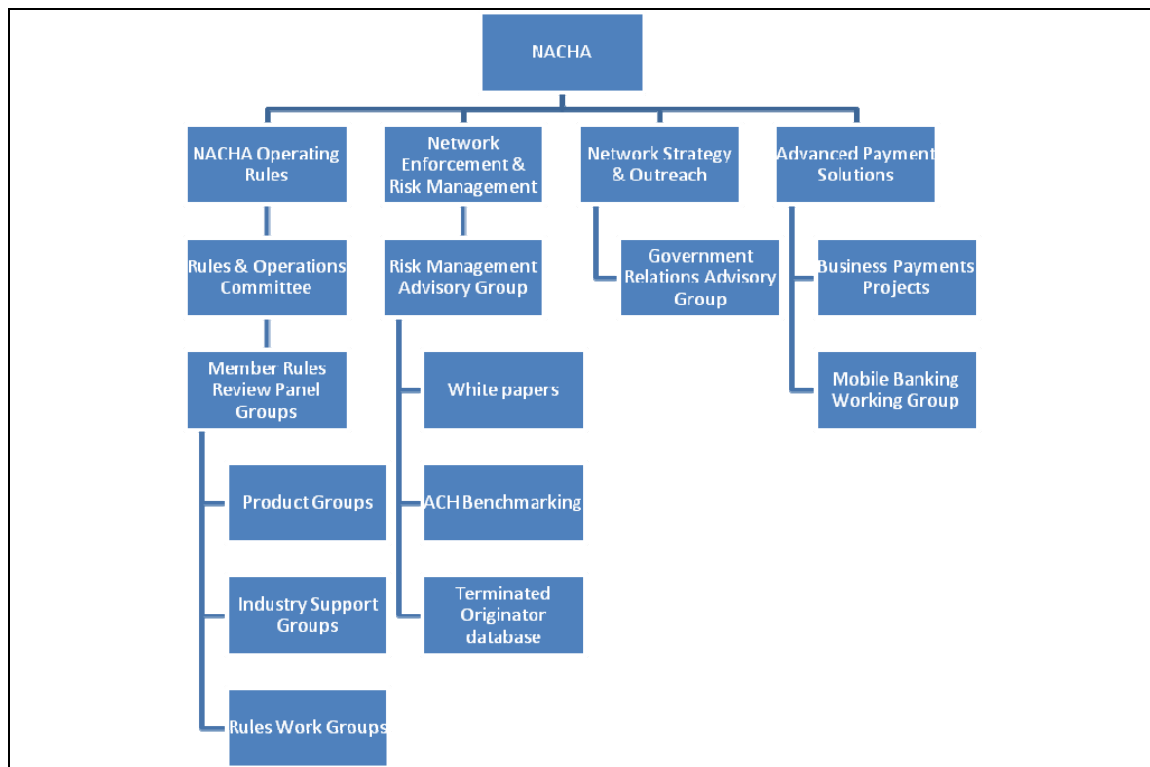
**NACHA characteristics**

- Board of directors
  - 19 direct members representing deposit-taking financial institutions that use the ACH network across the U.S.;
  - As the governing body of NACHA, provide guidance on strategic initiatives;
  - Responsible for organizational planning, fiscal accountability and acting in the best interests of NACHA and its members; and
  - Help “identify and support the interests of NACHA and the ACH network for the benefit of all its participants.”
- Eligibility
  - Direct members (which must be deposit-taking financial institutions insured by the Federal Deposit Insurance Corporation) can be board members and/or nominate and vote on board membership. In addition, the two ACH network operators—the Electronic Payments Network (EPN) and the Federal Reserve—have non-voting advisor positions on the board. There is a six-year term limit.
- Nominations
  - Direct members, as well as regional ACH associations and NACHA’s special interest councils, all nominate prospective board members, who are then elected by the voting membership. The 19-member board is a prescribed mix of direct members, smaller ACH participants (usually a regional player) and members of NACHA councils.

In addition, the two ACH network operators (the EPN and the Federal Reserve) have non-voting advisor positions on the board.

For rule making, NACHA’s extensive membership—including financial institutions, payments firms, government agencies, corporate users and business and consumer associations—can propose, help develop, and comment on ACH rules proposals. As financial institutions bear the financial risk and liability of introducing ACH transactions into the ACH network, the responsibility for approving changes to the rules lies with financial institutions and with the regional payment associations that represent them. Larger members have more votes (voting power is based in part on a member’s ACH volumes), but rules are in place to ensure that powerful members with more votes cannot impose their decisions on others.

Figure B4: NACHA organization chart



## References

Australian Payment and Clearing Association (APCA): <http://www.apca.com.au/>

Canadian Payments Association (CPA): <http://cdnpay.ca/>

European Payments Council (EPC): <http://www.europeanpaymentscouncil.eu/>

Single Euro Payments Area (SEPA) Council:  
[http://ec.europa.eu/internal\\_market/payments/sepa/council\\_en.htm](http://ec.europa.eu/internal_market/payments/sepa/council_en.htm)

NACHA (The Electronic Payments Association): <http://www.nacha.org/>

U.K. Payments Council: <http://www.paymentscouncil.org.uk/>

The Task Force also published a number of case studies that look at the payments systems of other countries, including some governance aspects. These can be found at <http://paymentsystemreview.ca/index.php/learn/resources-and-links/>.

## Annex B3: Self-governance in other industries

### Ontario Securities Commission<sup>24</sup>

The Ontario Securities Commission (OSC) is the regulatory body responsible for oversight of capital markets in Ontario, including equities, fixed income and derivative markets. It is a self-funded Crown corporation that is accountable, through the Minister of Finance, to the Ontario legislature. The OSC administers and enforces the provincial *Securities Act* and the *Commodity Futures Act*.

OSC oversight and assessment of compliance with regulatory requirements applies to marketplaces such as the TSX and alternative trading systems, self-regulatory organizations including the Investment Industry Regulatory Organization of Canada and the Mutual Fund Dealers Association of Canada, as well as for clearing agencies (Canadian Depository for Securities Limited).

#### *Mandate*

The OSC mandate is set by statute through the *Securities Act* and the *Commodity Futures Act*. The mandate is to provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in capital markets.

#### *The Commission*

The Commission consists of a minimum of nine and a maximum of 15 members (commissioners). Members are appointed by the Lieutenant Governor in Council for a fixed term.

As of December 31, 2011, there were 14 members—four full-time and ten part-time.

The Commission performs two independent, yet related, roles: security regulator and board of directors.

#### *Role as a regulator*

As a securities regulator, the Commission performs both a policy- and rule-making function and an adjudicative function. The Commission makes legally binding rules and adopts policies that impact market participants. A statutory process allows for public comments on proposed rules and policies during their development. All proposed rules are subject to review by the Minister of Finance, while ministerial review is not required for policies. In its adjudicative function, the Commission carries out administrative proceedings relating to the following:

- Enforcement matters and regulatory policy issues,
- Reviews of adjudicative decisions of self-regulatory organizations, and
- Reviews of decisions made by OSC staff.

Panels of members, acting as independent adjudicators, preside over the administrative proceedings. The chair does not sit on adjudicative panels since the chair oversees operational decisions relating to enforcement.

### ***Role as a board***

Commission members also serve as the OSC's board of directors. The board is responsible for management oversight of OSC financial affairs and for approving the annual strategic and operating plans and budgets.

The chair of the Commission is both chair of the board and chief executive officer, as set out under the *Securities Act*. To enhance the capacity for independent oversight by the board, part-time board members appoint a part-time member to act as lead director. The lead director oversees board operations, as well as the work of board committees.

The OSC board has three standing committees: Audit and Finance; Governance and Nominating; and Human Resources and Compensation. The chairs and members of these committees are part-time members. The chair of the Commission is also an ex-officio, non-voting member of the Governance and Nominating Committee.

### ***Accountability***

The OSC is accountable to the Ontario legislature through the Minister of Finance. The provincial *Securities Act* requires the Commission and the Minister to enter into a Memorandum of Understanding (MOU) every five years which outlines the roles and responsibilities of the Commission chair, board of directors, and the Minister, and also details the accountability relationship between them.

The MOU requires that the Minister be provided with annual reports, annual business plans, operational budgets, and any plans for proposed significant changes in activities or operations.

There is a statutory requirement for Ministerial approval of the following:

- Bylaws;
- Short-term borrowing;
- Commission regulations;
- Non-publication of Notice of Urgent Rule;
- Rules; and
- Agreements, memorandums of understanding, arrangements.

### ***Stakeholder input***

The OSC has a number of consultative committees through which it engages stakeholders:

- Continuous Disclosure Advisory Committee,
- Market Structure Advisory Committee,

- Mining Technical Advisory and Monitoring Committee,
- Registration Advisory Committee,
- Securities Advisory Committee,
- Small Business Advisory Committee, and
- Investment Funds Product Advisory Committee.

In addition, an Investor Advisory Panel responds to public requests for comment on proposed rules, policies, papers and discussion drafts.

## Public accounting standards in Ontario and Canada

### *Public Accountants Council of Ontario*

The *Public Accounting Act, 2004*, created a new Public Accountants Council (PAC) of Ontario. The PAC is a corporate body designed to ensure that Ontario public accounting meets standards that protect the public interest and are respected internationally. The Council develops new standards, and plays an oversight role of the accounting bodies and their licensing of members.

The Council:

- Develops and maintains standards to be met by each designated body in order to receive authorization to license and govern its members as public accountants;
- Determines whether a designated body has met or continues to meet the PAC Standards once being authorized for licensing and governance of its members;
- Oversees the capacity of each designated body to license and govern their members as public accountants; and
- Enforces the appropriate prosecution of offences under the Act in order to maintain public confidence in public accounting.

The designated bodies under the Act are as follows:

- The Certified General Accountants Association of Ontario,
- The Institute of Chartered Accountants of Ontario, and
- The Society of Management Accountants of Ontario.

### *PAC Standards*

The PAC Standards took effect in 2006 and meet the requirements laid out in the *Public Accounting Act*, including that they “shall be no less rigorous than the internationally recognized standards under the (former) *Public Accountancy Act* as they existed on June 9, 2004.” Those internationally recognized standards were the qualification and regulation standards that chartered accountants must meet.

The PAC Standards that took effect include the following:

- Rigorous education, examination and practical experience requirements that are substantially equivalent to the requirements that the Institute has established;
- The enforcement of exacting rules of professional conduct related to the practice of public accounting;
- Mandatory, cyclical practice inspection of licensees;
- Professional liability insurance programs for public accounting work;
- Continuing professional development requirements; and
- Comprehensive discipline mechanisms.

A designated body that seeks to be authorized to license and govern its members as public accountants must meet the Standards of the Council, including minimum standards with respect to the following:

- Education, examination and practical experience requirements;
- Rules of professional conduct, mandatory practice inspections of public accountants, the use of generally accepted accounting principles and generally accepted assurance standards, disciplinary procedures, the issuing of new licences to former licensees, the issuing of licences to persons who are permitted to practice in other jurisdictions, and mandatory professional liability insurance; and
- Governance standards respecting licensing and governing the activities of its members as public accountants.

### ***Governance structure***

The PAC consists of 17 people:

- 9 public representatives, including the Council chair, who are appointed by the Lieutenant Governor in Council;
- 4 chartered accountants (CAs) appointed by the Institute of Chartered Accountants of Ontario;
- 2 certified management accountants (CMAs) appointed by the Society of Management Accountants of Ontario; and
- 2 certified general accountants (CGAs) appointed by the Certified General Accountants Association of Ontario.

Each Council member is appointed for a term of up to three years and may be reappointed for as many as four additional terms. The chair and vice-chair are initially appointed for a two-year term, and may be reappointed for one additional term. The vice chair may also be appointed for up to two terms in a role other than vice-chair.

In addition, the PAC operates two committees: the Audit Committee and the Governance Committee. The Audit Committee is responsible for reviewing the PAC's financial statements, risk management processes, systems of internal controls and compliance. Its chair and the majority of

members are appointed by the Lieutenant Governor in Council. The Governance Committee is responsible for providing recommendations on Council membership and committee structure, as well as oversight of performance assessment of the Council, committees, Council members, chair, and chief executive officer. The Governance Committee consists of a member nominated by each of the three designated accounting bodies, along with three appointees of the Lieutenant Governor in Council—one of whom acts as the chair of the committee.

### ***Designated bodies***

Each of the designated bodies (the Ontario branches of the CA, CMA and CGA bodies) is self-regulating and accredits and regulates its members. Their respective acts and bylaws have incorporated the standards and regulations of the PAC and the *Public Accounting Act, 2004*. They develop regulations in accordance with the Standards of the Public Accountants Council for the Province of Ontario.

In addition, the provincial bodies are governed by the standards and practices that have been established by their national associations. In cases where legislation exceeds the standards and practices designated by the national associations, that legislation takes precedence, as is the case with the *Public Accounting Act* in Ontario.

The national association of each of the CA, CMA, and CGA bodies participates in or collaborates with a number of standards and oversight boards in order to contribute to the development and oversight of accounting standards both nationally and internationally. These include the Accounting Standards Board, the Accounting Standards Oversight Council and the International Federation of Accountants.

### ***Accounting Standards Board***

The Accounting Standards Board (AcSB) is an independent body responsible for developing and establishing accounting and reporting standards in Canada, for use in financial reporting by all entities outside of the public sector. These standards are the basis for the generally accepted accounting principles.

The objectives of the AcSB are as follows:

- To establish financial reporting standards and guidance that improve the quality of information reported by Canadian entities, principally annual and interim general purpose financial statements, with due consideration for the costs and the benefits to the preparers and users of financial statements of different categories of reporting entity, and changes in the economic environment;
- To facilitate the capital allocation process in both the business and not-for-profit sectors through improved information;
- To participate with other standard setters in the development of a single set of high-quality internationally accepted financial reporting standards; and
- To support the implementation of financial reporting standards and the resolution of emerging application issues.

***Accounting Standards Oversight Council***

Established in 2000, the Accounting Standards Oversight Council (AcSOC) was to serve the public interest by overseeing and providing input to the AcSB, with particular respect to the strategic direction and priorities of the AcSB. It also provides oversight to the PSAB (Public Accounting Standards Board) which is involved in public sector standard setting. The AcSOC supports domestic standard setting by the AcSB and PSAB, while also contributing to international standards development.

***International Federation of Accountants***

The International Federation of Accountants (IFAC) develops international standards with regard to ethics, education, auditing and assurance, and public sector accounting. IFAC has 164 members and associates across 125 countries, including the Canadian CA, CMA, and CGA bodies which, as members, follow the direction of IFAC on standards, and provide input to the development of internationally accepted standards.

The mission of IFAC is to serve the public interest by:

- Contributing to the development, adoption and implementation of high-quality international standards and guidance;
- Contributing to the development of strong professional accountancy organizations and accounting firms, and to high-quality practices by professional accountants;
- Promoting the value of professional accountants worldwide; and
- Speaking out on public interest issues where the accountancy profession's expertise is most relevant.

## Annex B4: Recommended governance model—Details

Many of these recommendations on specific aspects of the Task Force’s proposed governance model reflect the expert input and advice of the Governance Advisory Group. Lessons drawn from self-governance in other jurisdictions and industries provided an important starting point for much of this work.

### Public oversight body

Under the portfolio of the Minister of Finance, the public oversight body (POB) would:

- Have statutory authority to do the following:
  - Regulate and oversee the payments system and its participants for the public interest as set out in legislation;
  - Compel payments services providers to join the self-governing organization (SGO);
  - Recognize and oversee the SGO; and
  - Offer a recourse mechanism for issues that cannot be resolved within the SGO.
- Undertake to recognize the SGO, while maintaining the authority to set the terms and conditions of this recognition. Likewise, the POB would delegate some of its policy-making authority to the SGO, while reserving directive power over it.
- Retain residual regulatory powers over payments participants captured under the new payments legislation. Where there is an SGO that is functioning effectively, the POB would not normally intervene. Where there is no effectively functioning SGO, the POB would exercise the regulatory powers.

### Mandate

The POB would protect the public interest by conducting payments system oversight, including assessing the level of risk, competition, innovation and change. It would have an independent view on the evolution of the payments industry and be able to assess the effectiveness of the payments system governance model. The POB would monitor the implementation of necessary changes to the payments system to ensure that they serve the public interest and the needs of users—individual consumers, merchants, not-for-profit organizations, businesses and governments. The POB would, on behalf of users, ensure that the system is driven to inspire trust, to enable access and to provide good value.

The POB would hold directive power over the SGO for the public interest. It would determine, through the negotiation of a Recognition Order, specific aspects of the SGO’s governance and mandate, and how the POB will maintain the ability to direct the actions of the SGO in areas of public interest (for example, the POB might maintain authority to nominate or approve some or all of the SGO’s independent directors). In general, the POB would provide direction for the SGO on its priority setting and problem solving, as needed, including the main elements of a strategic direction for the evolution of the payments system.

The POB would evaluate the activities of the SGO and the Canadian Payments Association in light of the public interest, both broadly and narrowly defined. It would review and approve any important membership policies and operational processes, such as those for stakeholder engagement, as well as any SGO rules, policies, standards or codes of conduct that could reasonably impact the public interest. In carrying out these duties, the POB could hold related public consultations as deemed appropriate by the Board. The POB could also establish relationships with stakeholder groups to obtain input on developments at the SGO and in the industry, in order to identify emerging or potential concerns.

Finally, the POB would provide, as needed, a recourse process for dealing with unresolved conflicts at the SGO. For example, SGO decisions related to the setting of policies, standards or codes of conduct, as well as decisions regarding member compliance with them, would be eligible for appeal.

### ***Governance and operations***

**Relationship to the Minister of Finance:** As a public-purpose organization under the portfolio of the Minister of Finance, the POB would be subject to direction by the Minister and would report regularly (at least annually) on its oversight obligations and the results of its operations. It would provide advice to the Minister of Finance on policy, regulations and other matters related to its mandate. This arrangement would ensure that the Minister retained effective policy levers for influencing the payments system, consistent with the Minister's accountability for ensuring that the public interest is served.

**Board details:** The POB would be headed by a small board of five to seven senior people. Consistent with the demands placed on these individuals, board member expertise would need to include senior-level experience in public policy, strategic policy, payments and/or financial services, payments and/or financial services law, corporate or consumer/public interest issues. Following governance best practices, director responsibilities would be clear, with fiduciary duties to the POB. The Task Force determined, through consultation, that a Bank of Canada representative should sit on the board, given the need for coherence between the POB and Bank of Canada actions and decisions. The Task Force also determined that the board should be nominated by a committee of the Bank of Canada Governor (chair), the deputy ministers of Finance Canada and Industry Canada, and one independent member (who would be agreed to by the other three committee members). This committee would make recommendations to the Minister of Finance, for appointment through the Governor-in-Council process.

**Operational considerations:** The board would be supported by a secretariat, which would execute elements of the mandate and support the functioning of the board, with appropriate resources to carry out its tasks. The POB would have strong transparency provisions, with public records of decisions and actions, plus annual reports to Parliament tabled by the Minister of Finance.

## Self-governing organization

The SGO is envisaged as an organization with a broad membership and the vision to ensure that Canada is a world leader in payments for the benefit of Canadians and the Canadian economy. In providing a universal forum for the diverse interests of stakeholders for addressing challenges requiring collaboration, it would do the following:

- Set a strategic direction for the payments industry in support of its vision.
- Leverage member expertise and resources to collaboratively address collective challenges and opportunities in the payments system.
- Develop policies and standards, as well as participant codes of conduct, that support its mandate under payments legislation, providing a transparent and fair appeals mechanism regarding its decision-making and enforcement activities

While it would ultimately be up to the POB and the private sector to determine the mandate and form of the SGO, the Task Force has considered what a model SGO would look like. The details below also benefit from the work of the stakeholder-derived SGO Working Group.

### *Mandate*

The SGO would do the following:

- Set the strategic direction for the payments industry in Canada and facilitate payments competition and innovation in the Canadian system, as well as monitor the evolution of the payments system in a global context;
- Develop and enforce industry-wide policies and standards that further the strategic direction to make Canada's payments industry accessible, transparent and accountable, meeting the needs of users;
- Ensure that appropriate measures are in place to safeguard the integrity and soundness of the payments system and services, and their interaction with the broader financial sector, while furthering their operational efficiency and effectiveness;
- Lead industry efforts to promote interoperability with foreign payments systems and cooperation between payments and other industries regarding common technologies (e.g., digital identification and authentication);
- Provide a universal forum to balance the diverse interests of networks, payments service providers and the varied users of the payments system for addressing challenges; and
- Promote public understanding of payments in Canada.

While payment schemes and operators would remain responsible for their own strategic direction, innovation, and day-to-day management and operations, they would be bound by policies and standards developed by the SGO.

## Membership

The SGO would include, as mandatory members, the payment services providers and related entities defined by the payments legislation, for example:

- Financial institutions: Large and small banks, credit unions and other regulated financial institutions
- Non-financial-institution payments service providers, including newer entrants and acquirers
- Networks: Credit, debit, prepaid and open-loop gift-card issuers, clearing and settlement services, etc.
- Others in the payments value chain: Acquirers, payments software suppliers, processors, etc.

Users would be eligible to become voluntary members. This group would include consumer representatives, merchants, merchant associations, small and medium enterprises (SMEs), not-for-profit organizations, and large corporate and government organizations. The scope of SGO membership would be broader than that of payments bodies in other countries.

## Governance

The board would set the strategic direction for the SGO and determine the terms and the membership of the various committees and working groups. To ensure that the mandate is well executed, board members would be very senior individuals with expertise in payments, financial services and/or public policy. The board nominations process would have to ensure a transparent and fair selection process, diversity (geography and gender) and appropriate competencies.

Of the 12 board members, nine would be stakeholder directors (comprising a balanced mix of nominees provided by industry and user members), complemented by a group of three independent experts (including some from other jurisdictions or academia), one of whom would be the chair. All would be bound to act in the best interests of the SGO and not in the interests of any one stakeholder.

## Operational organization

The SGO would organize its work through a number of permanent and ad hoc committees or working groups, depending on the nature of the issues being addressed. There would also be four user advisory councils: consumers, retailers, SMEs, and large corporate and government organizations. Involvement of these councils in all stages of the SGO's policy-making and decision-making processes would be key to effective collaboration in the payments system.

The Task Force also hopes that the SGO will take up the mantle of supporting the transition to digital payments in Canada, as detailed in our report *Going Digital*. If it did so, the Task Force could envisage four broad priority areas, which would either be driven solely by the SGO or in collaboration with other private and public actors: electronic invoicing and payments, mobile payments, digital identification and authentication, and reinventing the CPA to provide the common payments clearing and settlement infrastructure that enables Canada to thrive in the digital economy.

## Infrastructure entity: A reinvented Canadian Payments Association

Through legislative amendments, the CPA would be transformed to provide a cost-effective and innovative core domestic infrastructure for payments processing, exchange, clearing and settlement, which ensures safety and soundness and provides a maximum amount of competitive space for payments service providers to differentiate themselves in the marketplace. Legislation and oversight from the POB would ensure that it has the following:

- A clear public interest mandate to balance cost-effectiveness and innovation objectives;
- Open access to its networks for participants who meet objective and transparent minimum criteria, to enhance competition;
- A transparent and independent governance structure to avoid the concentration of decision-making power; and
- A business and funding model that provides for user-pay, and the ability to make ongoing strategic capital investments to support innovation and competition.

### *Mandate*

The reformed CPA would operate in the public interest by:

- Providing a safe and robust core domestic infrastructure for retail and wholesale payments clearing and settlement that maintains the trust of Canadians;
- Operating a cost-effective payments infrastructure, which provides a maximum amount of competitive space for payments service providers to differentiate themselves in the marketplace;
- Developing, through a transparent, consultative process, a strategic business plan to innovate its networks in response to stakeholder needs and market opportunities;
- Allowing open access to its networks for participants who meet objective and transparent minimum criteria, to enhance competition; and
- Maintaining a funding model that provides for user-pay, and the ability to make strategic capital investments that support systemic stability, innovation and competition.

### *Participants and governance*

Participants would be payments service providers who qualify for access. Governance would be transparent and effective, avoiding any concentration of decision-making power in the hands of one or a few stakeholders. Taking the form of a non-share capital corporation, the organization would have no shareholders and participant stakeholders would not have a vote in decision making. The board would be vested with all decision-making power.

The reformed board would therefore need to follow governance best practices. Board members would be of senior stature and independent of specific stakeholder influence. They would have a fiduciary duty to the interests of the CPA, and be chosen based on competencies and on a nominations process outlined in the payments legislation.

Given the dynamics at play, including the need to ensure stakeholder input but independence from the influence of any one stakeholder or class of stakeholders, the CPA board could be composed of nine members, as follows:

- Three federal government appointees;
- Three participant appointees; and
- Three independents, one of whom would serve as chair.

The Bank of Canada would sit on the board in an observer capacity.<sup>25</sup>

The Task Force also determined that:

- The SGO would be responsible for nominating the three participant appointees;
- The proposed nominating committee for the POB would nominate the three government appointees; and
- The six appointed board members would nominate the three independent board members.

## Annex B5: Flexibility and balance in governance

While the details in Annex B4 demonstrate the Task Force’s in-depth thinking about the specific actors in the recommended governance model, the Task Force is also seeking to provide a high degree of legal and institutional flexibility to allow the federal government and private stakeholders to determine the best governance underpinnings for the Canadian payments system.

### *Stakeholder-led vs. government-led solutions*

Conceptually, payments system governance could be envisaged as a spectrum, combining differing degrees of government-led and stakeholder-led solutions:



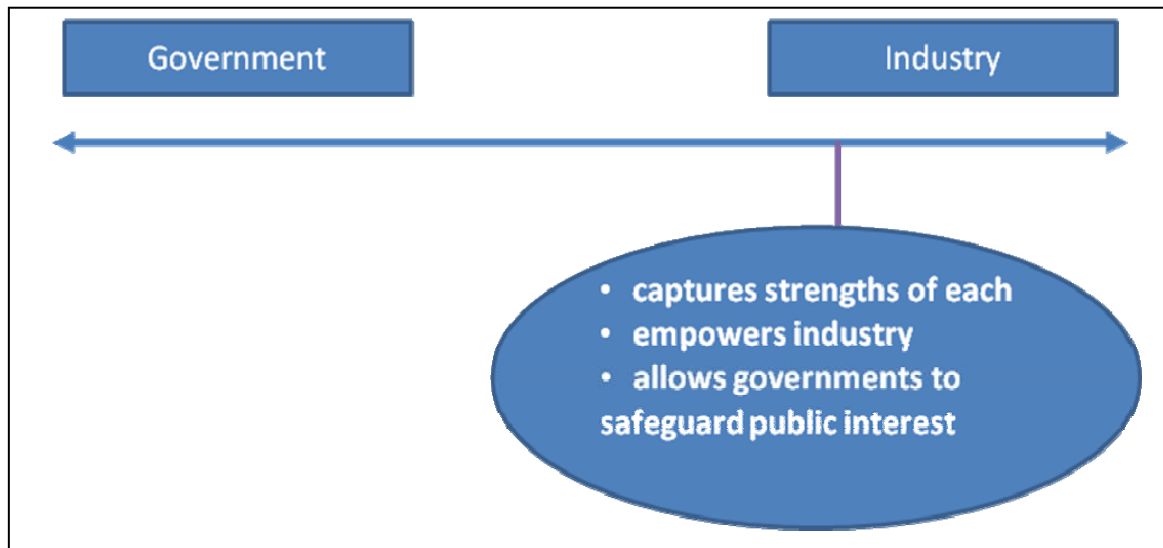
While it is unlikely that only one side would provide all of the leadership, it is useful to spell out the benefits and potential risks of each.

**Table B2: Benefits and potential risks of solutions**

	<b>Government-Led Solutions</b>	<b>Stakeholder-Led Solutions</b>
Benefits	Public policy/interest focus Consultation and balancing of stakeholder interests Political accountability and transparency	Industry collaboration, which can build trust and good will Collaboration on numerous issues allows “horse-trading” to help reach agreement on individual issues Leveraging of subject-matter expertise
Potential risks	Imposed solutions, which may leave all stakeholders with unfulfilled goals Missing nuances of industry realities Negative externalities (e.g., distorting market incentives in unforeseen ways)	Lack of collective will to recognize and/or address issues, as well as the ability to compel others to respect decisions Some issues might not be suitable for resolution in the private sector (e.g., those involving competition law/policy) Decisions made by dominant players, for their benefit Insufficient stakeholder consultation Negative externalities for some stakeholders or for the Canadian financial system and broader economy Lack of political accountability and transparency

The challenge, then, is to determine a governance model that maximizes the benefits that can be derived from private and public actors while mitigating the potential risks through a robust independence and accountability structure for the industry:

**Figure B5: Government and industry balance**



In essence, the legal and institutional approach being recommended would give the federal government the flexibility to implement a specific solution that could range anywhere between fully government-led and fully industry-led.

The Task Force believes that rather than a governance structure that is financial institution-centric and reactive, the payments system needs a model that is flexible and that provides the government with effective tools to promote public policy goals in a strategic and proactive manner. It must also allow all stakeholders the opportunity to participate in the governance of the system—it must enable participants to drive change, while respecting legislation to avoid government-imposed outcomes.

The Task Force is therefore recommending a governance model and supporting legislation that provide a strong basis to protect the public interest, while maintaining the maximum amount of flexibility to adjust the balance between private and public leadership and oversight to match the evolving reality of the payments system over time.

It is the Task Force's strong hope that the private sector recognizes the collective value in self-governance and finds the needed will to undertake it. The optimal outcome would be one where the payments industry and user stakeholders shape their future, balanced by light-touch public oversight to ensure that the public interest is being served.

## Notes

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<sup>1</sup> In the United States, Verizon has recently blocked access to Google Wallet on its cell phones, illustrating how the interaction of new stakeholders impacts the evolution of the payments ecosystem: Goldman, David. *Verizon Blocks Google Wallet*. CNN Money.com, December 6 2011, at [http://money.cnn.com/2011/12/06/technology/verizon\\_blocks\\_google\\_wallet/index.htm](http://money.cnn.com/2011/12/06/technology/verizon_blocks_google_wallet/index.htm).

<sup>2</sup> Networks such as Interac for debit, the Canadian Payments Association for clearing and settlement, Visa and MasterCard, are all examples of organizations that began as and, in some cases, remain, member-based associations.

<sup>3</sup> The Reserve Bank of Australia, in its discussion paper *Strategic Review of Innovation in the Payments System: Issues for Consultation*, points to several examples of how the network effects of payments systems can stand in the way of market outcomes that are in the public interest.

<sup>4</sup> The Code can be found at <http://www.fcac-acfc.gc.ca/eng/industry/obligation/codeCond/conductCode-eng.asp>.

<sup>5</sup> *Payments Council seeks views on governance and performance*, [http://www.paymentscouncil.org.uk/media\\_centre/press\\_releases/-/page/1892/](http://www.paymentscouncil.org.uk/media_centre/press_releases/-/page/1892/).

<sup>6</sup> EC Directives are agreed to by the European Parliament, after which EU member countries are expected to ratify and implement them into domestic law. The Payment Services Directive (PSD) was agreed to in 2007. The PSD requires that each country designate a competent authority to provide prudential supervision of the providers and to monitor compliance with the business conduct rules, as implemented in national legislation.

<sup>7</sup> The Ontario Securities Commission (OSC) mandate is set by statute: “To provide protection to investors from unfair, improper or fraudulent practices, and foster fair and efficient capital markets and confidence in capital markets.” We have not examined closely the regulatory frameworks implemented in other provinces, and we propose the Ontario model as an example, thus acknowledging that regional variations exist in the regimes that have been implemented, especially in Quebec.

<sup>8</sup> The OSC defines an SRO as an entity that is organized for the purpose of regulating the operations and the standards of practice and business conduct of its members and their representatives with a view to promoting the protection of investors and the public interest.

<sup>9</sup> These standards are the basis for the generally accepted accounting principles.

<sup>10</sup> Self-governance as a model is gaining some traction internationally in the area of payments. See, for example, APCA’s submission to the Reserve Bank of Australia’s strategic review of innovation in the Australian payments system:

<http://www.rba.gov.au/payments-system/reforms/strategic-review-innovation/submissions/201106-strategic-review-innovation/apca-governance.pdf>

<sup>11</sup> The governance aspects of this body are explored below, while *Policy Paper D: Infrastructure* provides further analysis and rationale for the Task Force’s recommendations regarding the shared payments infrastructure.

<sup>12</sup> See, for example, the Canadian Payments Association’s response to *The Way We Pay: Transforming the Canadian Payments System*, Discussion paper of the Task Force for the Payments System Review, August 2011.

<sup>13</sup> Transactions that take place within a given financial institution or other entity.

<sup>14</sup> *Strengthening Canada’s Anti-Money Laundering and Anti-Terrorist Financing Regime*. Available at <http://www.fin.gc.ca/n11/11-142-eng.asp>.

<sup>15</sup> The current CPA mandate, as set out in the *Canadian Payments Act*, expressly directs the CPA to facilitate the development of new payment methods and technologies.

<sup>16</sup> Many laws and regulations focus on issues related to payments, such as sales contracts or cost of credit disclosure.

<sup>17</sup> For discussions of economic theories related to payments networks, see, for example: Klemperer, Paul (March 2005), “Network Effects and Switching Costs: Two Short Essays for the New Palgrave,” [www.paulklempere.org](http://www.paulklempere.org); Farrell, J. and P. Klemperer (2007), “Coordination and Lock-In: Competition with Switching Costs and Network Effects” in M. Armstrong and R.H. Porter (eds.), *Handbook of Industrial Organization*, Volume 3, Elsevier, pp. 1967-2072; and Reserve Bank of Australia (June 2011), “Strategic Review of Innovation in the Payments System: Issues for Consultation.” <http://www.rba.gov.au/publications/consultations/201106-strategic-review-innovation/pdf/201106-strategic-review-innovation-issues.pdf>

<sup>18</sup> The OFT’s mission is to “make markets work well for consumers...by promoting and protecting consumer interests...and ensuring that businesses are fair and competitive.” It investigates issues that affect consumers, and, if there is a clear competition question, it can refer specific cases to the U.K. Competition Commission.

<sup>19</sup> Members included the OFT, British Bankers’ Association, the British Chambers of Commerce, the British Retail Consortium, the Building Societies Association, the Electronic Money Association, the Federation of Small Businesses, Consumer Focus, and Which? (formerly the Consumers’ Association). The Bank of England and U.K. Treasury attended the task force as observers.

<sup>20</sup> Independent directors are selected by an Appointments Committee comprising four directors, two of whom are industry directors and two of whom are independent directors, chaired by an independent director who has a casting vote.

<sup>21</sup> The benefits of full membership include the right to nominate or vote for a board representative; the right to attend, speak and vote at general meetings; the provision of information; and early consultation. All members have the opportunity to give their views on board papers to directors before board meetings. Membership fees for all full members are charged in proportion to qualifying U.K. payment volumes using bands and are determined annually by the board.

<sup>22</sup> Source: Hartsink, Gerard. SEPA Implementation, May 2007, page 9. [http://ec.europa.eu/internal\\_market/payments/docs/sepa/conf-hartsink\\_en.pdf](http://ec.europa.eu/internal_market/payments/docs/sepa/conf-hartsink_en.pdf)

<sup>23</sup> Source: European Payments Council. [http://www.europeanpaymentscouncil.eu/content.cfm?page=what\\_is\\_epc](http://www.europeanpaymentscouncil.eu/content.cfm?page=what_is_epc)

<sup>24</sup> Source: [www.osc.gov.on.ca](http://www.osc.gov.on.ca)

<sup>25</sup> The Bank’s oversight mandate for designated clearing and settlement systems provides the Bank with specific levers for influencing the infrastructure company, but there is also merit in providing the Bank with a direct view of board proceedings. Its interest in the infrastructure entity would be focused on the designated systems (e.g., LTVS) and on any board actions or decisions that could impact payments or financial system stability.