

Looking Ahead: The Canadian Payments Act

Five Years of Significant Legislative Change

The second half of the 1990s was an active period for changes in federal financial legislation, and two acts were passed that were of fundamental significance for the CPA. The first, the Payment Clearing and Settlement Act of 1996, was important because the clearing and settlement processes within the LVTS gained additional legal force through the provisions of the act, as well as through actions taken subsequent to its passage. In 1999, the Bank of Canada, with the approval of the Minister of Finance, designated the LVTS as falling within Bank oversight in matters relating to the control of systemic risk. As a result of this designation, the system gained protection against legal challenge from stays of a failed participant, which in turn, supported the certainty of settlement and finality of LVTS transfers.

The second legislative change was Bill C-8, one of the most extensive omnibus pieces of legislation ever put before Parliament, approaching 1,000 pages in length. Included in Bill C-8 was the Canadian Payments Act, which updated and refined the CPA's mandate, expanded the membership, and added new governance features. This act was given royal assent in June 2001. The preparation of the regulations containing the detail necessary to implement many of the provisions of the act were completed in the course of 2002.

The Canadian Payments Act

Rather than the two legislated objectives for the Association contained in the CPA Act of 1980; namely, “establish and operate a national clearings and settlements system and . . . plan the evolution of the national payments system,” the 2001 legislation stated in section 5 that:



R.M. (Bob) Hammond, General Manager of the Canadian Payments Association, 1990–2003.

“The objects of the Association are to: (a) establish and operate national systems for the clearing and settlement of payments and other arrangements for the making or exchange of payments; (b) facilitate the interaction of its clearing and settlement systems and related arrangements with other systems or arrangements involved in the exchange, clearing or settlement of payments; and (c) facilitate the development of new payment methods and technologies.”

In addition, section 5 added a duty, stating that “In pursuing its objects, the Association shall promote the efficiency, safety and soundness of its clearing and settlement systems and take into account the interests of users.” Depending on one’s interpretation of the section, it was possible to say that the CPA’s role in the payments system had been expanded—or just clarified. (The story of the *second* two decades of the CPA may someday provide a conclusive answer.)

The new act expanded the types of financial institution eligible to join the CPA, adding three new classes: life insurance companies, securities dealers, and money market mutual funds. The greater breadth of Association membership held the potential for increased competition, better service to the users of payment services, and enhanced innovation. At the same time, the increased heterogeneity worked in the direction of more complex risk control. The act provided careful definitions of each of the three new types of members, and the subsequent regulations established particular requirements that applicants from the mutual funds and the securities dealers classes would have to fulfill. Moreover, an additional distinction was made in this area—the difference between access to CPA membership, on the one hand, and eligibility for direct clearer status in the ACSS, on the other. As a matter of government policy, neither life insurance companies nor money market mutual funds were allowed to function in the ACSS as direct clearers.¹

The Canadian Payments Act also changed the composition of the CPA’s Board of Directors. The new Board would consist of a Chairperson appointed by the Bank of Canada; 12 directors to be elected to represent the seven classes of institution (banks, centrals, trust and loan companies, qualified corporations and trusts associated with money market mutual funds, securities dealers, life insurance companies, and “other” members), and three directors appointed by the Minister of Finance. Six seats were allocated to the bank class and six were assigned to the other classes of financial institution. In total, the new Board had 16 members, as opposed to

1. Canada, Department of Finance, *Reforming Canada’s Financial Services Sector, A Framework for the Future* (Ottawa: Department of Finance Distribution Centre, 1999), 41.

11 on the Board that was established in 1980. The increased diversity was expected to noticeably multiply the points of view expressed at meetings of both the Board and its various standing committees.

The third major change in the legislation, which informed the future work of the Association, was the altered oversight structure. In addition to the oversight of the LVTS by the Bank of Canada pursuant to the Payment Clearing and Settlement Act, the Minister of Finance gained the authority to disallow, in whole or in part, any new rule or amended rule of the Association within 30 days following its submission. Moreover, the Minister could, after consultation with the Board and any interested party, issue a written directive to the Association “to make, amend or repeal a by-law, rule or standard.” Such a power of directive was expected to be very rarely used, if ever. On the other hand, the practical and ongoing implications for the Association of the requirement to interact with the Department of Finance whenever the CPA Board approved new or revised rules (of which there were dozens every year for largely operational reasons) raised concerns on the part of some observers about the ability of the Association to act sufficiently quickly in a future that was expected to involve rapid technical change.

Observed Trends at the Start of the Millennium

Three broad and continuing trends relevant for any national payments system were evident as the new millennium began: (1) globalization, (2) financial consolidation, and (3) technological developments. The following paragraphs explore each trend in turn, noting how events during the first 20 years of the CPA illustrated the importance of these broad phenomena for the evolving world of money and payments.

Globalization, in this context, is the movement by deposit-taking institutions towards a comprehensive cross-border orientation of their strategies, management, and operations with respect to payments services. National arrangements are gradually being linked in the context of new and broader structures. A clear illustration of this trend was the introduction, in 2002, of Continuous Linked Settlement, which was expected to reroute about one-quarter of the daily value flow of large-value payments in Canada (and indeed globally) through a new cross-border facility operated by the CLS Bank. The CPA had to respond to this development and will probably have to do so again in the context of further cross-border arrangements, particularly those in North America.

Consolidation among the global institutions that focus on financial services, particularly in the context of transaction processing, had been well documented.² The trend was expected to continue, largely a result of the drive for even greater economies of scale and scope. Canadian institutions were (for reasons of public policy) less likely to engage in mergers than was the case elsewhere. Instead, Canadian banks were reaching out to similar partners in other countries and to specialized companies both at home and abroad that provided services such as the processing of cheques and card transactions. The new mandate of the Association to “facilitate the interaction of its clearing and settlement systems and related arrangements with other systems or arrangements involved in the exchange, clearing or settlement of payments” was, thus, quite appropriate.

Lastly, there was ongoing pressure to take advantage of evident *technological advances*. At the start of the millennium, the one advance that stood out as being of particular importance to the CPA was the Internet. The Internet had entered peoples’ lives and work environments in the late 1990s in such a pervasive, inexpensive, and user-friendly manner that both personal and professional patterns of communication were substantially transformed. The implications for the national payments system—for the medium of exchange—were judged by the CPA Board to be fundamental. Accordingly, the CPA spent over \$4 million during 2001 and 2002 to create a cryptographic infrastructure to facilitate the development of secure payment methods using Internet technology. While not viewed by the Board as “planning the evolution of the national payments system,” this initiative was a conscious effort to enhance the nature, and to accelerate the pace, of that evolution.

2. See Group of Ten, *Report on Consolidation in the Financial Sector* (Basel: BIS, 2001). Chapter 6 covers the effects of consolidation on payment and settlement systems.