

## New Regulation of Payment Service Providers in Canada

Suhuyini Abudulai

May 10, 2021

In the 2021 federal budget, the federal government has introduced the long-awaited *Retail Payments Activities Act* (the Act). We previously reported on the proposed retail payments system framework in our article “New Retail Payments System Framework Regulating Payment Service Providers.”

### Scope of Application

The Act will apply to any “retail payment activity” performed by a “payment service provider” (PSP) that has a place of business in Canada, and will also apply to any retail payment activity performed for an “end user” in Canada by a PSP that does not have a place of business in Canada but directs retail payment activities at individuals or entities that are in Canada.

The following defined terms in the Act are relevant:

- An “**end user**” is an individual or entity that uses a payment services as a payer or payee.
- A **PSP** is an individual or entity that performs payment functions as a service or business activity that is not incidental to another service or business activity.
- A “**retail payment activity**” is a “payment function” that is performed in relation to an electronic funds transfer that is made in Canadian currency or currency of another country or using a unit that meets prescribed criteria.
- A “**payment function**” means:

the provision or maintenance of an account that, in relation to an electronic funds transfer, is held on behalf of one or more end users;

the holding of funds on behalf of an end user until they are withdrawn by the end user or transferred to another individual or entity;

the initiation of an electronic funds transfer at the request of an end user;

the authorization of an electronic funds transfer or the transmission, reception or facilitation of an instruction in relation to an electronic funds transfer; or

the provision of clearing or settlement services.

- An “**electronic funds transfer**” is the placement, transfer or withdrawal of funds by electronic means that is initiated by or on behalf of an individual or entity.

## Exemptions

The Act will not apply to the following retail payment activities:

- a payment function that is performed in relation to an electronic funds transfer that is made with an instrument that is issued by a merchant — or by an issuer that is not a PSP and has an agreement with a group of merchants — and that allows the holder of the instrument to purchase goods or services only from the issuing merchant or any merchant in the group (such as closed-loop gift cards);
- a payment function that is performed in relation to an electronic funds transfer that is made for the purpose of giving effect to an “eligible financial contract” as defined in the *Canada Deposit Insurance Corporation Act* for the purpose of giving effect to a prescribed transaction in relation to securities;
- a payment function that is performed in relation to an electronic funds transfer that is made for the purpose of a cash withdrawal at an automatic teller machine;
- a payment function performed by a system that is designated under the *Payment Clearing and Settlement Act*;
- a payment function between a PSP and affiliated entity;
- payment functions performed by prescribed entities including banks, authorized foreign banks, credit unions, the Bank of Canada (the Bank), insurance companies, trust companies, and a provincial government that accepts deposits;
- payment functions performed by agents of registered PSPs; or

- any other prescribed retail payment activity.

## Requirements under the Act

### Registration

A PSP will be required to be registered with the Bank prior to performing any retail payment activities. The Bank will maintain a public registry of registered PSPs, disclosing the PSP's name, address, and any other prescribed information. The Bank will also maintain and publish a list of PSPs that have been refused registration or have had their registration revoked, including the reasons for refusal or revocation. The Act prescribes reasons for refusing a registration including a failure to be registered as a money service business under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*.

A prescribed registration form must be used to register and there will be a registration fee with the application.

### Operational and Financial Measures

For purposes of identifying and mitigating operational risks and responding to incidents, a PSP is required to establish, implement and maintain a risk management and incident response framework that meets prescribed requirements under the Act. The Bank may assess the framework and request corrective measures at its discretion. "Operational risk" is defined in the Act as a risk that any of the following will result in the reduction, deterioration or breakdown of any retail payment activity that is performed by a PSP:

- a deficiency in the PSP's information system or internal process;
- a human error;
- a management failure; or
- a disruption caused by an external event.

A PSP will have a duty to notify the Bank of any "incident" that has a material impact on an end user, PSP, and a clearing house of a clearing and settlement system as those terms are defined in the *Payment Clearing and Settlement Act*. An "incident" is defined in the Act as an event or series of related events that is unplanned by a PSP and that results in or could reasonably be expected to result in the reduction, deterioration or breakdown of any retail payment activity that is performed by the PSP.

### Safeguarding Funds

# Cassels

If a PSP performs a retail payment activity that involves holding end-user funds until the funds are withdrawn or transferred, the PSP must:

- hold the end-user funds in trust in a trust account that is not used for any other purpose;
- hold the end-user funds in a prescribed account or in a prescribed manner and take any prescribed measures in relation to the funds, the account or the manner; or
- hold the end-user funds in an account that is not used for any other purpose and hold insurance or a guarantee in respect of the funds that is in an amount equal to or greater than the amount held in the account.

The foregoing requirements do not apply to a PSP in respect of end-user funds it holds in a province if the PSP accepts deposits that are insured or guaranteed under legislation that province and those end-user funds are deposits that are guaranteed or insured under such legislation.

## **Reporting Requirements**

PSPs will be required to submit an annual report to the Bank, containing prescribed information. Notification to the Bank, containing prescribed information and within a time period to be specified in the regulations made under the Act, is required of any significant change in retail payment activity.

## **Supervisory Authority**

The Bank will have supervisory authority over PSPs that perform retail payment activities in order to determine compliance with the Act. Additionally, the Act directs the Bank to promote the adoption by PSPs of policies and procedures designed to implement their obligations under the Act and to monitor and evaluate trends and issues related to retail payment activities. In performing these duties, the Bank of Canada must consider the efficiency of payment services and the interests of end users.

## **Administration and Enforcement**

The Bank may request a PSP to provide any information considered necessary for purpose of verifying the PSP's compliance with the Act, and a PSP must respond to the request within a prescribed period. The Bank may also direct a special audit of a PSP in accordance with conditions that the Bank considers appropriate where, in its opinion, the special audit is required to verify compliance. The PSP will be responsible for the expenses incurred in respect of the special audit.

The Act also provides for access by an authorized person to examine the records and inquire into the business and affairs of a PSP for verifying compliance with the Act (including by way of a warrant).

The Bank may enter into a compliance agreement with a PSP for purposes of furthering compliance with the Act. Notice of violation of the Act may be issued by the Bank and administrative monetary penalties may be levied up to a maximum of \$10 million. Notably, an individual or entity will be liable for any violation committed by any of its employees, third-party service providers, or agents or mandataries, whether or not any of the foregoing that actually committed the violation is identified.

## Transitional Provisions

A transitional period will be provided for PSPs to register as required under the Act. Further details on the new measures proposed in the Act will be included in the regulations made thereunder.

---

*This publication is a general summary of the law. It does not replace legal advice tailored to your specific circumstances.*